The Bank Pocztowy S.A.
Capital Group

Management Report on the Activities
of the Bank Pocztowy S.A. Capital Group
for 2016

Bank Pocztowy

Table of Contents

Letter from the Chairman of the Supervisory Board

Przemysław Sypniewski
Chairman of the Supervisory Board

Szanowni Państwo,

The year 2016 was a turning point for the development strategy of companies from the Poczta Polska Capital Group. It was the first year when Poczta Polska reported an increase in the sale of traditional postal services. At the same time, we are fully aware that we will need to diversify our operations, develop modern services and grow in our role of the Universal Service Provider, which has been assigned to the Group until 2025. Therefore, we want to increase the Group's profitability, offering a wide range of services, in particular financial ones, rendered at a post office. Such services are provided by the Capital Group of Bank Pocztowy, whose performance in 2016 has been presented in this Report.

In 2016 the Bank Pocztowy Capital Group generated a net profit of PLN 2.5 million. Decisions made in the previous years had considerably affected the Group's performance. The most important decisions concerned credit risk management and resulted in very high impairment losses recognized in 2016 for cash loans and advances granted in 2013-2016 and the need to recognize provisions for proceedings instigated by the Office for Competition and Consumer Protection concerning fees for bank statements charged since 2015.

Rendering services through its own outlets and the network of post offices, in 2016 the Bank Pocztowy Capital Group offered various bank products, including cash loans, under names emphasizing the relation to the Poczta Polska Capital Group, for instance "Post Office Loan". The Group focuses on these products in order to increase the share of high-margin assets in the balance sheet of the Group, in line with its strategy. Consequently, the balance of loans reached PLN 5.5 billion and the deposit balance adjusted to the lending activity amounted to PLN 5.8 billion. At the same time, the Bank's key capital ratios, including the solvency ratio, complied with the regulatory requirements.

Significantly, in the recent months, the Bank strove to improve management processes in its key functional areas and to activate own sales network and the wide network of Poczta Polska. Additionally, in effect of development works related to the new EnveloBank brand carried out in 2016, the Bank Pocztowy Capital Group will offer mobile banking services. Therefore, the Group will efficiently pursue its mission to prevent financial exclusion and provide access to bank services to consumers from every corner of the country.

The demand for banking services observed outside of big cities, i.e. in smaller towns and rural Poland may be satisfied by products and services offered by the Bank Pocztowy Capital Group. The success of a postal banking model with majority interests held by postal operators in France or Switzerland, where such bank generate 25% of post office revenues in these countries, proves a great unused growth potential for Bank Pocztowy in Poland.

I am certain that we will unlock this potential working hand in hand with other entities from the Poczta Polska Capital Group.

Z wyrazami szacunku

Letter from the Chairman of the Management Board

Sławomir Zawadzki
Chairman of the Management Board

Szanowni Państwo,

The year 2016 presented in this Report has been particularly demanding for the Bank Pocztowy Capital Group.

On the one hand, the Group generated a net banking income of PLN 339.1 million, i.e. 3.5% higher than last year and reported a 6.4% higher balance of cash loans and installment loans and a 5.9% growth in deposits granted to individuals. In the same period the net interest income grew by 4.2%, which translated into a higher interest margin, which considerably exceeded the average for commercial and cooperative banks.

On the other hand, many negative factors adversely affected the Group's performance in 2016. The most important of them was the recognition of higher impairment losses on loans and advances, which significantly impacted this year's performance. The impairment losses increased by PLN 35.3 million (up by 50% YoY) and reached PLN 100.5 million in 2016. The adverse change resulted from the credit policy followed in 2013-2016, which did not sufficiently hedge the Group's credit risk and which will adversely affect its performance in the coming years. Therefore, the Management Board appointed for the tenth term of office implemented a strategy aimed at improving the quality of the loan portfolio.

Another significant factor, with a detrimental impact on the profit for 2016 was the recognition of provisions for proceedings instigated by the Office for Competition and Consumer Protection of PLN 10.1 million concerning fees for bank statements charged since 2015. The Group's performance was also affected by a payment to the Bank Guarantee Fund of PLN 0.8 million following the bankruptcy of Bank Spółdzielczy in Nadarzyn and writing off expenses incurred in the process of preparing the IPO in 2015 and 2016 of PLN 3.2 million. The total impact of non-recurring events in 2016 was PLN 16.5 million.
Other factors affecting the Group's performance were: low interest rates and a bank tax charged since 1 February 2016, which equaled PLN 4.8 million.

The Group's performance was positively affected by the sale of shares in VISA Europe to VISA Inc. for PLN 16.9 million.

The Bank Pocztowy Group reported a net profit of PLN 2.5 million in 2016. Significantly, if not for the wrong decisions of the management taken in previous years and negative impact of one-off events, the net profit would have reached PLN 40 million.

At the end of 2016, the Bank provided services to 1.3 million consumers and managed over 830 thousand current accounts, which gave the Bank a good market share of 2.7%. The quality of accounts maintained with Bank Pocztowy has improved, i.e. current account holders have become more active and the average balance of funds deposited has increased by 30% comparing to last year.

In the analyzed period the Bank followed the balance sheet optimization strategy aimed at increasing the share of more profitable assets, i.e. cash loans and installment loans, which have become key products of the Bank in the recent years. The value of these loans reached PLN 2.2 billion. Gross loans amounted to ca. PLN 5.5 billion and the balance of deposits reached PLN 5.8 billion. The solvency ratio amounted to 14.4% and Tier 1 reached 11.1%, i.e. it exceeded the minimum regulatory level required.

The key challenge for the Bank has been to improve the quality of the credit portfolio, therefore, in the recent months the Bank carried out intensive works to introduce necessary changes to the policy, processes, credit procedures and to make organizational changes. By the end of the first quarter of 2017 the New Credit Process for Cash Loans will be introduced to streamline the credit approval process and improve the quality of loans granted and the credit portfolio.

In 2016 the Bank made organizational changes aimed at improving the management quality at the Bank and activate own sales network. Changes have been made to the incentive scheme for the network employees and the first incentive scheme in the last few years has been introduced to motivate the sales staff of the extensive network of Poczta Polska. Considering the importance of the changes for the Bank's growth and financial performance, in the coming years the works will be intensified to promptly develop an optimal cooperation model.

Additionally, the Bank carried out a project of developing new digital banking system under the EnveloBank brand and successfully launched the public issue of bonds scheme. As a result of the bond issue the Bank raised the assumed maximum amount of PLN 50 million.

At present the Bank is working on a new strategy which will enable it to take its natural place in the Polish financial market - to become a people's bank. We are certain that this growth direction will comply with the strategy followed by the entire Poczta Polska Capital Group and, consequently, the Bank' s customers will gain access to an integrated offer of traditional and modern bank services, postal, government administration (e-administration) and e-commerce services. The Bank finds is particularly important to develop strong local relations with the majority shareholder - Poczta Polska. Therefore, we will foster and encourage cooperation to render services to our clients in line with European postal banking standards. Consequently, both institutions will be able to grow the revenue and generate better performance in the coming years.

Z wyrazami szacunku

Sławomir Zawadzki

Bank Pocztowy

Summary of the year 2016

267.7 (PLN milion) net interest income +4.2% YoY	23.6 (PLN million) gain on financial instruments +74.9% YoY	339.1 (PLN million) income +3.5% YoY
5.5 (PLN billion) gross loans As at 31.12.2016	5.8 (PLN billion) deposits As at 31.12.2016	6.9 (PLN billion) balance sheet total As at 31.12.2016
1,142.9 thousand individual clients As at 31.12.2016	167.0 thousand microenterprises As at 31.12.2016	158 thousand new invididual clients and microenterprises As at 31.12.2016

General Information about the Bank Pocztowy Capital Group

Bank Pocztowy (Bank) is a consumer bank providing safe and simple financial services through the network of Poczta Polska, its own offices operating countrywide and through mobile channels. Its business model is based on strategic partnership with Poczta Polska, which ensures exclusive access to its distribution network and a wide consumer portfolio in provincial Poland.

The mission of the Bank, the parent of the Bank Pocztowy Capital Group (the Bank Pocztowy Capital Group, the Capital Group, the Group) is defined as "simple, safe and well-priced banking". For consumers it implies:

- focus on the simplest products, processes and communication;
- good price guaranteed to a wide group of consumers;
- modern financial services based on integration within the Poczta Polska Capital Group.

Bank Pocztowy focuses on consumer banking and the offer for microenterprises.

Poczta Polska S.A. is the key shareholder and business partner of Bank Pocztowy holding 75% -10 shares in its share capital. Powszechna Kasa Oszczędności Bank Polski S.A. also holds shares in the Bank (25% +10 shares).

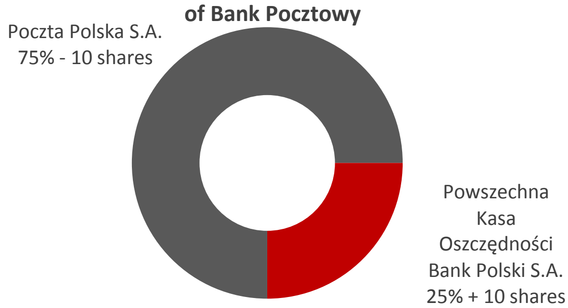
Thanks to the strategic alliance with Poczta Polska, the Bank's services and products are available in ca. 4.7 thousand outlets and offices countrywide. Apart from Poczta Polska, Bank Pocztowy offers its services and products through 217 own offices, electronic distribution channels (online and telephone banking) and a network of mobile agents of its subsidiary – Spółka Dystrybucyjna Banku Pocztowego Sp. z o.o. Additionally, the Bank's products are distributed by ca. 23 thousand postmen and selected agents. The wide distribution network constitutes a unique competitive advantage of the Bank.

At the end of 2016 the Bank provided services to 1,309.9 thousand consumers and microenterprises. In 2016 it acquired 158 thousand new clients in this group. The Bank served over 14.9 thousand of entities in the institutional segment. Consequently, at the end of 2016 the Bank had about 1,324.8 thousand clients in consumer and institutional segments. The number of customers decreased following a review of consumer accounts aimed at updating the consumer base.

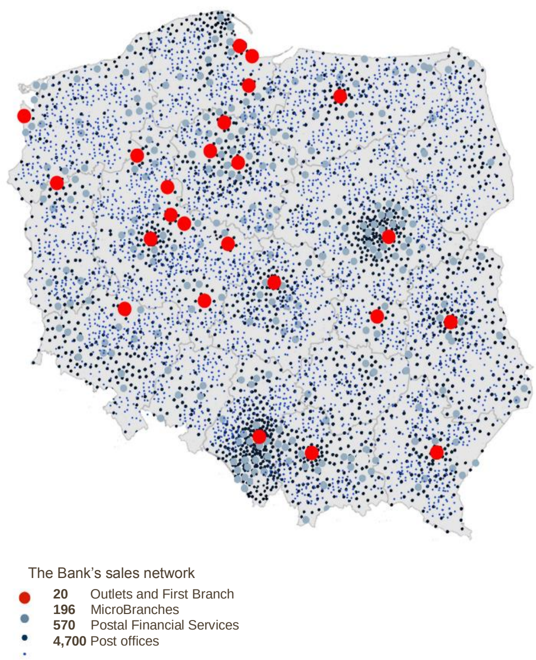
In 2016 the Capital Group generated a net profit of PLN 2.5 million.

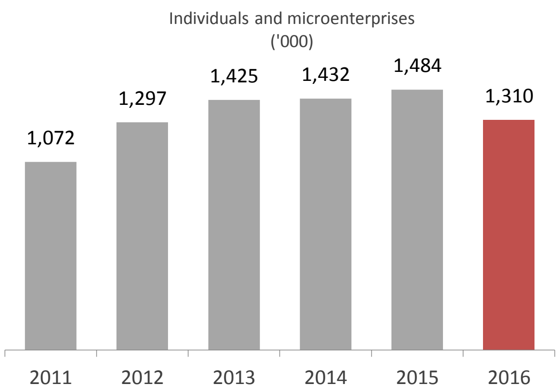
The Group's revenue reached PLN 339.1 million in 2016 and was 3.5% higher than in 2015.

Shareholding structure of Bank Pocztowy



Sales network of Bank Pocztowy

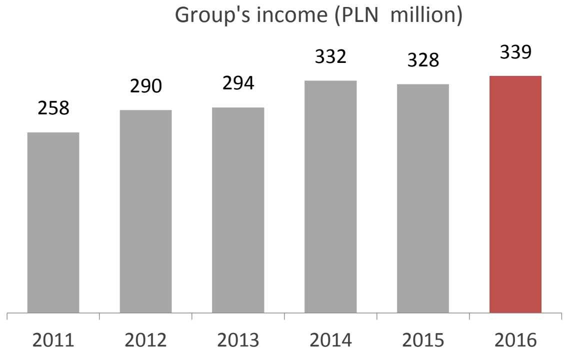


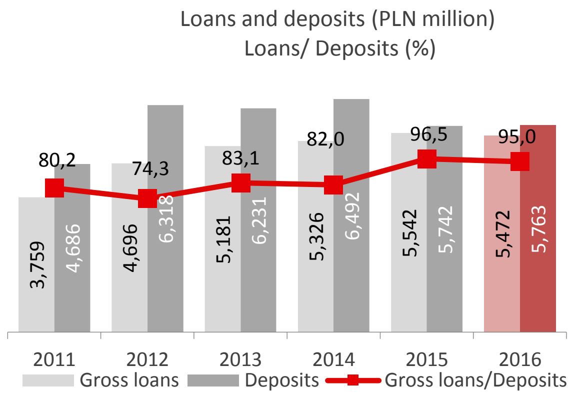


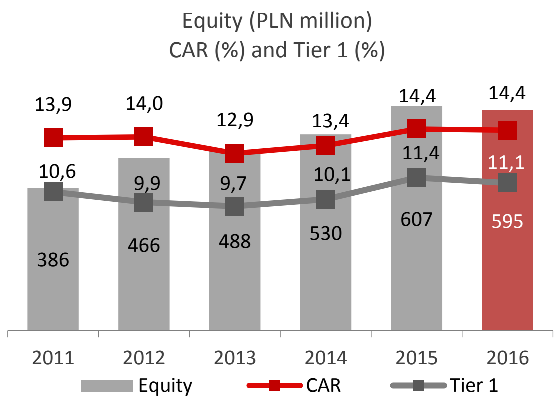
As at 31 December 2016, the balance sheet total of the Group amounted to PLN 6,936.6 million and represented 0.4% of the total assets of the Polish banking sector[1]. The total gross loans and advances granted to clients amounted to PLN 5,472.2 million with 86.5% of consumer loans. Liabilities to the Group's customers amounted to PLN 5,763.0 million, including over 81.7% of funds obtained from the consumer sector. With its 2.7%[2] share, the Group has gained a relatively good position in the current accounts market thanks to dynamic growth reported in the last few years and the increase in the number of consumers.

During 2016, the Group maintained its liquidity ratios at a safe level, and its capitals were adequate to the scale of operations. At the end of the year the relation of loans and advances to deposits stood at 95.0%. As at 31 December 2016 the solvency ratio amounted to 14.4% and Tier 1 reached 11.1%.

At the end of 2016 headcount in the Group reached 1,546 FTEs versus 1,618 in 2015.





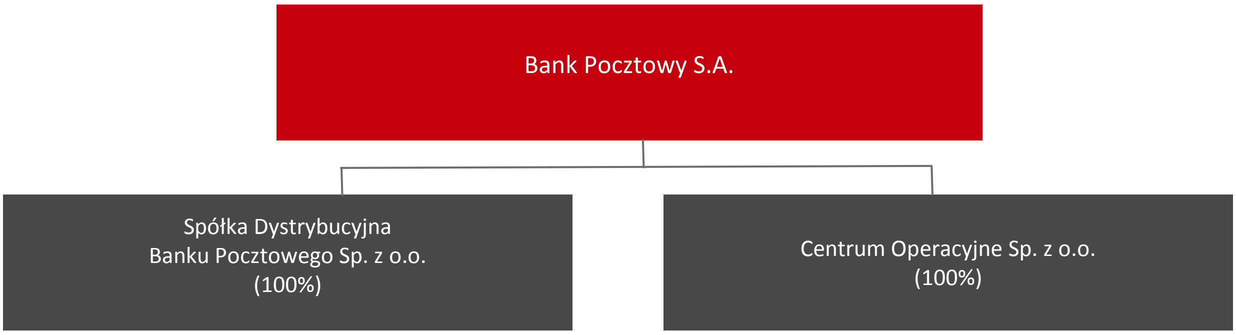


Subsidiaries of the Bank play an important role in implementing the strategy of the Capital Group. They include:

- Spółka Dystrybucyjna Banku Pocztowego Sp. z o.o. (Spółka Dystrybucyjna), whose key objective is to support distribution channels of Bank Pocztowy and access prospect clients from remote locations.
- Centrum Operacyjne Sp. z o.o. (Centrum Operacyjne) providing professional services including administration processes for products and services to the Bank, the clients of the Capital Group and Poczta Polska.

[1]Source: Financial Supervision Authority, monthly data for the banking sector file – December 2016.
[2]Source: PRNews.pl Current account market – Q3 2016, 23 November 2016.

Bank Pocztowy Capital Group



The Bank started operations in 1990 and the reactivation of postal banking in Poland was the idea underlying its establishment. To this aim and in order to develop the Bank, the GIRO non-cash settlement system was launched to enable fast and easy processing of bulk payments, reduce costs of issuing and circulating cash in the economy and to provide bank services to clients, in particular consumers, through a wide distribution network of Poczta Polska. Therefore, initially the Bank was a typical settlement bank with performance highly related to the volume of settlements with Poczta Polska.

In 1998, transformation into a consumer bank was initiated. The Bank started to reach an increasingly large group of clients through the sales network of Poczta Polska and own branches and points of sale. At the same time, it started to launch new products.

In 1999 all post offices provided comprehensive services related to GIRO personal accounts and, additionally, Visa Electron cards to the accounts were offered. In 2003, the Bank launched its website. Two years later, in 2005, *GIRO* personal accounts were renamed to *Pocztowe Konto Nestor* for elderly people and *Pocztowe Konto Standard*.

Agreement concluded by the Bank and Poczta Polska in 2006 regulating the terms of cooperation between the institutions in consumer banking services was a breakthrough event for the Bank's consumer business. Under the agreement over 2 thousand Postal Financial Points were opened in post offices by the end of 2009 to streamline service provision to the Bank's customers by post office staff. Following the gradual changes and development of the sales network, in February 2010 the number of clients exceeded 500 thousand, in October 2011 it was 1 million, and at the end of 2016 it reached 1.3 million.

In 2010 the Bank's subsidiaries: Spółka Dystrybucyjna Banku Pocztowego Sp. z o.o. and Centrum Operacyjne Sp. z o.o. were established and commenced business activities. As a result, the Bank Pocztowy Capital Group was set up.

Historical overview

1990

Bank Pocztowy was registered in Bydgoszcz in 1990. Since its origination it has been related to Poczta Polska and the reactivation of postal banking in Poland was the idea underlying its establishment.

During 25 years Bank Pocztowy has transformed from a settlement institution into a retail bank. Its business model is based on strategic partnership with its key shareholder, Poczta Polska, which enables it to provide services using one of the largest outlet networks in Poland.

1990 -2001

1990
registration of a settlement institution Bank Pocztowy

1998
transformation into a consumer bank was initiated

1999
uGIRO Składka account offered to microenterprises by Bank Pocztowy and Poczta Polska

2000
GIRO accounts divided into Standard and Nestor accounts

2003 -2005

2003
launching the website of Bank Pocztowy

2005
Pocztowe Konto Standard and Nestor replace GIRO accounts

2006 -2011

2006
agreement concluded by Bank Pocztowy and Poczta Polska underlying the principles of retail banking services provision and the current business model of Bank Pocztowy

2007
launching the first online banking website Pocztowy24 for consumers

2009
launching the first online banking website Pocztowy24 for institutions. Transformation into a consumer bank

2010
opening first Microbranches, incorporating Spółka Dystrybucyjna and Centrum Operacyjne; the Bank Pocztowy Capital Group is established

2011
number of clients of Bank Pocztowy exceed one million. Bank's bonds IPO, Catalyst

2012 -2016

2012
exclusivity agreement with Poczta Polska

2015
strategy of Bank Pocztowy aimed at becoming the top retail bank for provincial Poland by way of simplification of the product offer, processes, procedures, communication and even more efficient use of the network and cooperation with Poczta Polska

2016
bond issue scheme for individual investors

Key data of the Bank Pocztowy S.A. Capital Group for 2011-2016	2011	2012	2013	2014	2015	2016	Change 2016/2015
Key financial data:							
Group's income [1]/ (PLN'000)	258,473	290,255	294,320	332,340	327,528	339,081	3.5 %
Administrative expenses (PLN '000)	(209,837)	(218,356)	(212,738)	(218,622)	(217,030)	(224,898)	3.6 %
Net impairment losses (PLN'000)	(12,877)	(25,099)	(42,398)	(61,013)	(65,158)	(100,496)	54.2 %
Gross profit (PLN '000)	37,531	48,665	43,260	55,145	42,879	7,312	(82.9)%
Net profit (PLN '000)	29,555	38,949	36,027	43,639	33,931	2,510	(92.6)%
Balance sheet:							
Balance sheet total (PLN '000)	5,215,801	7,120,653	7,382,745	7,719,027	7,213,030	6,936,566	(3.8)%
Loans and advances granted to customers[2]/(PLN'000)	3,679,382	4,599,545	5,055,712	5,151,777	5,312,882	5,154,339	(3.0)%
Liabilities to customers (PLN'000)	4,685,735	6,317,949	6,230,578	6,492,023	5,742,377	5,763,014	0.4 %
Equity (PLN'000)	321,395	361,470	391,765	439,632	542,485	523,442	(3.5)%
Key ratios:							
Net ROA (%)	0.6	0.6	0.5	0.6	0.5	0.04	(0.46) p.p.
Net ROE (%)	9.6	11.4	9.6	10.5	6.9	0.5	(6.4) p.p.
Costs including amortization / income (C/I)[3]/ (%)	80.6	74.7	71.3	65.3	66.8	67.6	0.8 p.p.
Solvency ratio [4]/(%)	13.9	14.0	12.9	13.4	14.4	14.4	0.0 p.p.
Tier 1 [4]/ (%)	10.6	9.9	9.7	10.1	11.4	11.1	(0.3) p.p.
NPL [5]/ (%)	5.0	4.7	5.4	6.1	7.0	8.9	1.9 p.p.
Net interest margin to total assets [6] / (%)	4.1	3.8	3.6	3.8	3.6	3.7	0.1 p.p.
Business figures:							
Headcount (FTEs)	1,496	1,571	1,700	1,633	1,618	1,546	(4.4)%
Number of offices	161	227	295	293	284	217	(23.6)%
Number of consumers and microenterprises ('000)	1,072	1,297	1,425	1,432	1,484	1,310	(11.7)%

1. Net interest income, net fee and commission income, gain/loss on financial instruments measured at fair value through profit or loss, gain/loss on foreign exchange transactions, realized gain/loss on other financial instruments and dividend.
2. Net loans and advances.
3. Income increased by gain/loss on other revenue and operating expenses.
4. As at 31 December 2014 and 31 December 2015 and 31 December 2016 CAR and Tier 1 values were calculated in accordance to the Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. Pursuant to the above regulations, the Bank has been released from the obligation to determine its consolidated capital requirements. Separate data.
   In the remaining years CAR and Tier 1 values were calculated In accordance with Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010 regarding the scope and detailed principles of determining capital requirements due to various risk types (as amended). Separate data.
5. NPL – the share of impaired loans and advances in the gross loan portfolio.
6. Net interest margin calculated as a relation of net interest income for a given year to average assets (calculated as average daily balance of assets).

Business model of Bank Pocztowy

Bank Pocztowy is a Polish consumer bank with a simple offer responding to basic and actual needs of consumers. The Bank offers its clients well-priced services rendered based on integration with Poczta Polska in the form of common product initiatives and the sales network.

Simple

The Bank provides comprehensive financial services and products adjusted to clients' needs, friendly environment, clear procedures and understandable communications. It offers simple products in the Polish zloty to institutional clients and operates in the settlement and treasury segment as well.

Inexpensive

The Bank offers financial services at affordable prices through the largest network in the market: through Poczta Polska outlets, Bank's outlets and remote channels.

Translation

Which is Bank Pocztowy?

- *The simplest – The bank is specialized in the simplest products*
- *Cheap – The bank is quaranting reasonable price for broad range of Customers*

Integrated with Poczta Polska – The bank is offering modern financial services based on integration in the Poczta Polska Group.

Integrated with Poczta Polska

Its business model is based on strategic partnership with Poczta Polska (75% of shares minus 10 shares of the Bank), which ensures exclusive access to its distribution network and a wide consumer portfolio in provincial Poland. Providing comprehensive services to the Poczta Polska Capital Group, the Bank plays the role of a center of excellence and a supplier of financial services including banking services, bancassurance and investment products in the Poczta Polska Capital Group.

At the end of December 2016 the elaborate distribution network encompassed over 4.7 thousand post offices, including 570 Postal Financial Zones and 217 Bank offices, including 196 Microbranches located in post offices. The network has been expended to incorporate online banking services (Pocztowy24) and telephone banking (Contact Center and PocztowySMS) and provides the Bank's services countrywide.
The other shareholder of the Bank is PKO BP holding 25% of interests plus 10 shares).

Competitive advantages

The competitive advantages discussed below constitute key factors, which enable the Bank to achieve its strategic objectives.

Strategic alliance between the Bank and Poczta Polska.
The Bank's business model is based on a strategic partnership with the key shareholder, Poczta Polska, which ensures exclusive access to its distribution network (on terms stipulated in the Cooperation Agreement) and a wide consumer base in regional Poland.

Bank and insurance service are one of the main pillars of the strategy followed by the Poczta Polska Capital Group. Poczta Polska assumes that the share of bank and insurance products in its revenue structure will grow considerably by 2019. The Bank's contribution is also important for the financial performance of the Poczta Polska Capital Group.

Poczta Polska is the top provider of postal services in Poland, rendering services for consumers and corporations countrywide.

Poczta Polska is one of the largest Polish enterprises in terms of the distribution network (the total of over 7.4 thousand offices of various kind as at 31 December 2016), including over 4.7 thousand outlets distributing bank and insurance products. Thanks to its extensive network and a wide services scope Poczta Polska can reach nearly every Pole. Moreover, having won the tender Poczta Polska will act as a universal service provider of postal services from 1 January 2016 to the end of 2025 under the decision of the Office of Electronic Communication. Therefore, it will operate a great number of distribution outlets countrywide, as required by applicable regulations.

The Bank operates and pursues its strategy based on resources and infrastructure of Poczta Polska, hence gaining access to a wide group of clients, in particular in provincial Poland, in particular in smaller towns countrywide.

Thanks to the strategic partnership with Poczta Polska and access to its clients Bank Pocztowy can acquire new clients at low costs, with no need to incur high expenditure on advertising campaigns born by competitors or on own distribution network.

Access to the distribution network of Poczta Polska
Under the Cooperation Agreement and other related agreements concluded with Poczta Polska the Bank has gained exclusive access to the distribution network of Poczta Polska. It constitutes a considerable competitive advantage of the Bank in terms of customer acquisition countrywide (including areas of low banking penetration). Therefore, over 50% of existing clients of the Bank live in rural areas and towns of less than 5 thousand inhabitants, and ca. 70% in towns with population to 50 thousand. According to the Bank, clients from smaller towns are less willing to acquire bank services, buy fewer bank products and visit traditional bank outlets more often than big city clients. Unbanked clients from rural areas and small towns are the target group of the Bank, which can be reached through the extensive distribution network. The lowest cross-sell ratio has also been observed in rural areas and smaller towns.

Under the Agency Agreement with Poczta Polska, postmen of Poczta Polska can carry out acquisition activities and offer selected services of the Bank, for instance deliver cash to the Bank's clients.

Access to the client base of Poczta Polska
The access to the distribution network of Poczta Polska enables the Bank to offer its products to Poczta Polska's clients. It is particularly important in areas, where the competition in financial services is less intense, i.e. in rural Poland and small towns. For these market relationship banking model is of key importance to enable making transactions and purchasing bank products in bank offices.

Image of a secure and stable Polish bank

Poczta Polska, which is directly controlled by the State Treasury, is the majority and controlling shareholder of the Bank. In time of financial market uncertainty, thanks to the indirect involvement of the State Treasury the Bank is perceived as a secure and stable Polish financial institution, offering an alternative for other financial institutions and lenders operating in regional Poland.

In regional Poland the Bank competes not only with other banks but also with credit unions, which undergo restructuring, and other lenders, which are not subject to regulatory supervision. According to the Management Board of the Bank, its image of a stable and secure financial institution significantly affects clients' decision to acquire financial products.

Bank Pocztowy compared to other commercial banks and cooperative banks.[3]

The Polish banking sector may be divided into commercial banks and cooperative banks. According to the Polish Financial Supervision Authority 36 commercial banks and 558 cooperative banks operated in Poland at the end of December 2016.

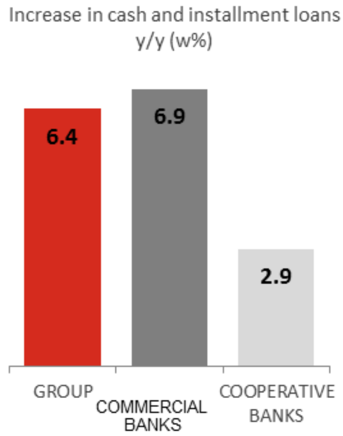
Since the Group had focused on consumers in 2009, the growth in loans and advances granted by the Group to consumers in the years 2009-2016 was much higher than in the entire banking sector and in the group of cooperative banks. The average annual growth in consumer deposits acquired by the Group in the years 2009-2016 amounted to 24.5%. The average annual growth in liabilities to consumers in the entire banking sector in the same period was 6.8% and 6.2% in the group of cooperative banks.

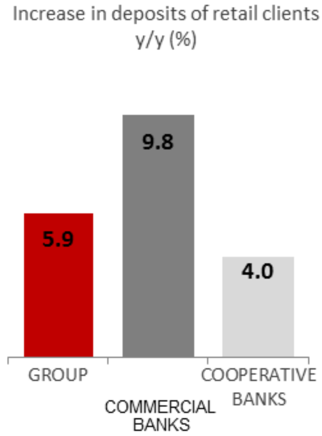
Similarly, the growth in deposits of consumers in the years 2009-2016 was considerably higher than in the commercial banking sector and in the group of cooperative banks. The average annual growth in consumer deposits acquired by the Group in the years 2009-2016 amounted to 20.1%. The average annual growth in liabilities to consumers in the entire commercial banking sector in the same period was 9.5% and 11.7% in the group of cooperative banks.

In 2016 the Group still focused on the offer targeted at consumers, in particular on cash loans and installment loans. Following the adoption of the policy in 2016, the balance of cash loans and installment loans reached PLN 2,161.3 thousand, i.e. it increased by 6.4%. The Group reported a growth at the level similar to that of the commercial bank sector (6.9%) and much higher than in the cooperative bank sector (2.9%).

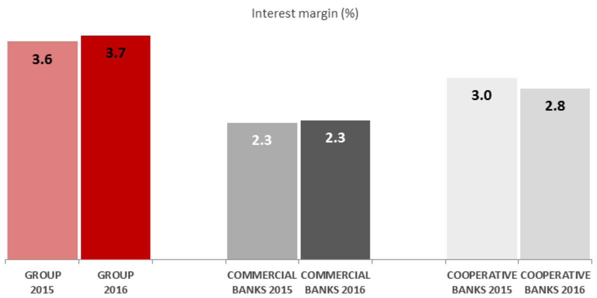
In accordance with the data of the Polish Financial Supervision Authority, the increase in consumer loans in the entire banking sector resulted from low interest rates, less severe criteria of credit approval, for instance as a result of the improved situation in the labor market and higher demand of households, whose credit standing have improved following the launch of the Family 500+ program.

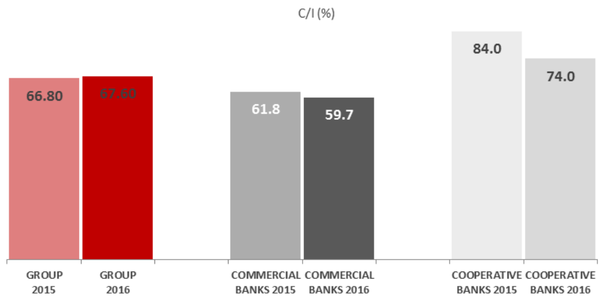
[3] Source: Financial Supervision Authority, monthly data for the banking sector file – December 2016.





In 2016 consumer deposits with commercial banks increased by 9.8% YoY. The increase in the deposit base resulted from the launch of the Family 500+ program providing financial support to large families and the improved situation in the labor market. Another factor was the deflation observed during the entire year 2016. On the other hand, record low interest rates of the National Bank of Poland still discouraged consumers from depositing funds with banks. The increase in the consumer deposit base of the Group was 4.0% higher than in the cooperative banking sector.





Interest margin, ROE for the banking sector – the denominator specifies the asset level with interest margin and capital level for ROE at the end of 2016 and the end of 2015.

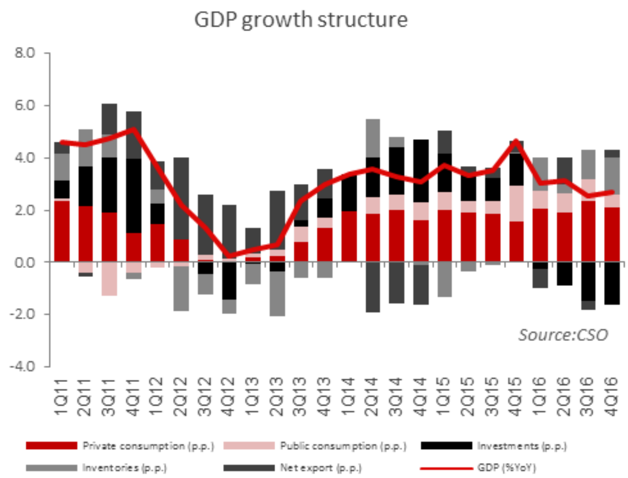
A 4.2% increase in the net interest income of the Group (YoY) and stable market interest rates resulted in a growth in the interest margin by 0.1 p.p. up to 3.7%. Significantly, the Group's margin was considerably higher than in the entire commercial banking and cooperative banking sectors.

C/I ratio of the Bank measuring operating efficiency in commercial banks and cooperative banks improved comparing to 2015, while in the Group, the ratio dropped by 0.8 p.p. comparing to the previous year due to significant non-recurring events. The ratio for the Group is higher than in cooperative banking sector.

1. External Factors

1.1. Key trends in the economy

Gross Domestic Product and its components



In 2016 the Polish economy grew slower than a year before. In line with the data of the Polish Central Statistical Office, the GDP growth amounted to 2.8%, while in 2015 it had reached 3.9%. The slower growth rate resulted mainly from lower investments in the economy. They dropped by 5.5% although in 2015 they had grown by 6.1%. The main reason was the delay in the use of EU funds under the 2014-2020 Perspective, mainly by local administration and high uncertainty related to the external and internal environment, which made companies postpone their investment initiatives. On the other hand, household consumption expenditure growth of 3.6%, which was the highest level since 2008, fostered the economic growth in 2016. Higher household consumption expenditure resulted from improved situation in the labor market, higher purchasing power of wages related to deflation observed in the entire 2016 and the transfer of PLN 17.3 billion to families with children under the Family 500+ Program. In line with the calculations of the Central Statistical Office, in 2016 the share of the net exports in GDP amounted to 0.1 p.p. only, as compared with 0.6 p.p. in 2015 due to faster growth in imports of goods of services than in exports.

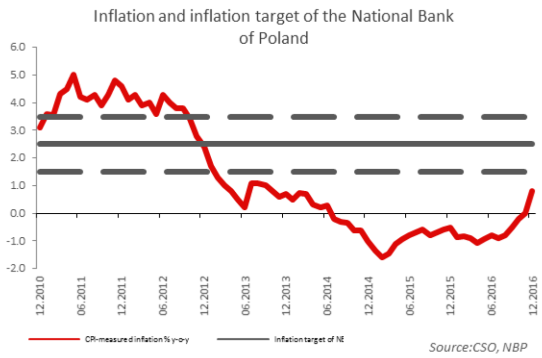
Labor market

Labor market trends have not changes considerably since 2014. At year-end, the unemployment rate dropped from 9.7% at the end of 2015 to 8.3%, which was the lowest ratio in the last 25 years. In 2016 unemployment decreased in Poland despite lower investments in the economy. The decisive factors were the talent shortage in certain industries and lower labor supply observed in the last few years resulting from demographic processes and economic emigration.

The year 2016 was another year of employment growth in the business sector. In December 2016, 5,799 thousand people worked in the business sector, as compared to 5,626 thousand in December 2015. Employment in the business sector grew during the entire 2016 and in December the growth rate reached 3.1% (versus 1.4% a year before). Higher employment in the business sector positively affected consumption of households on the one hand and increased savings of households on the other. In particular, it was difficult to find competent talents in industries which generally report labor shortages. Moreover, a number of companies which postponed new investment projects decided to hire new staff.

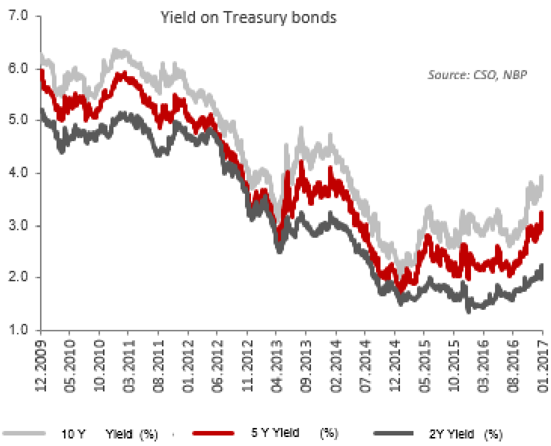
In 2016, the growth in employment (unemployment reduction) was accompanied with an increase in salaries and wages in the business sector. Nominal annual growth of wages reached 4.1%, as compared to 3.5% in 2015. As deflation has been observed in the last few years, the increase in real wages was higher than the nominal growth and amounted to 4.7% versus 4.5% in 2015.

Prices of goods and services



In 2016 the consumer price index amounted to – 0.6% (versus – 0.9% a year before), which implies a considerable deviation from the inflation target of the National Bank of Poland. Annual deflation was reported until October, when it reached 0.2% YoY and then, in December inflation of 0.8% YoY was observed. The key reasons for lower prices in Poland reported nearly during the entire 2016 were considerably low prices of world energy resources, including crude oil (although insignificant growth has been observed), lower costs of using flats (following a decrease in prices of gas and electricity) and still relatively low prices of food. In February 2016 world oil prices were the lowest since 2004 (BRENT crude oil price was USD 38.18 and NYMEX - USD 26.21). Subsequently, they started to grow, due to the reduction in production volumes heralded by key suppliers. At the same time, the American dollar strengthened versus other currencies, including the Polish zloty, which translated into a considerable increase in retail prices of fuel at the end of the year. Despite the Russian embargo on European agricultural and food produce imposed in July 2014 the prices of food increased, because food manufacturers managed to adjust to the new circumstances and acquire new buyers. Despite the increased consumption demand in 2016, core inflation rates remained low. Moreover, at the beginning of the year, core inflation rate (excluding prices of food and energy) was negative for the first time since 2006. In 2016 average core inflation rate amounted to -0.2% versus +0.3% in 2015.

Public finance and the treasury debt securities market

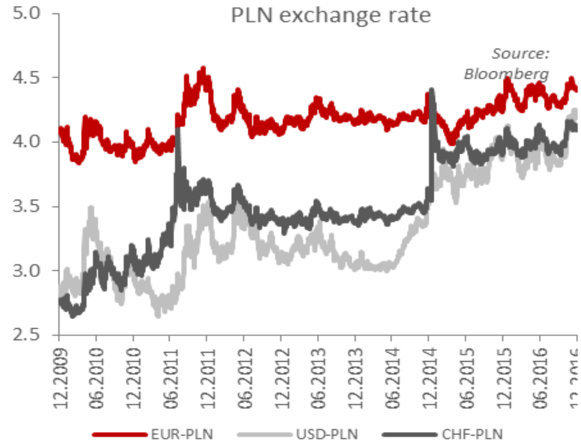


In 2016 the public finance and in particular the tax income was affected by long-term deflation. The average annual deflation amounted to 0.6%, while the Ministry of Finance projected average annual inflation of 1.3% in the Budget Act of March 2016. The economic growth rate of 2.8% also proved much lower than assumed in the Budget Act (3.8%). Still, the key reason for the economic slowdown was not a decrease in consumer demand but lower investments, so finally the budget revenue was not affected. To support the budget in 2016 the Minister of Finance took steps to improve the efficiency of the VAT collection system. According to the data of the Ministry of Finance in December 2016 the budgetary deficit amounted to PLN 46.3 billion (vs. PLN 54.74 billion projected), i.e. 84.6% of the amount planned for the entire year. The budget revenue reached 314.6 billion, i.e. 100.3% of the annual plan, while the expenditure stood at PLN 360.9 billion, i.e. 97.9% of the amount planned for 2016.

Like in the previous years, in the first half of 2016 the Ministry of Finance focused on selling a major part of Treasury bonds planned for sale in a given year. The Ministry of Finance started pre-financing borrowing needs of the State Budget for 2016 in 2015, therefore in December 2015 it found financing for 20% of the annual needs, at the end of June it was 70% and the process was completed in November. At the same time, the Ministry commenced pre-financing borrowing needs of the State Budget for 2017 and at the end of 2016 ca. 27% was pre-financed. Further quantitative easing works of the European Central Bank carried out in March 2016 and deferring increases in interest rates in the U.S. by Fed (finally increased in December) and eliminating assets in the form of Treasury bonds from the taxable amount of banks also positively affected the prices of Polish Treasury securities. On the other hand, the deterioration of the S&P credit rating of Poland and the negative outlook assigned in January, the deterioration of the Moody's rating to negative in May 2016 and the Brexit referendum in June exerted a short-term negative impact on Treasury securities. Negative external factors, which affected the Polish debt market accumulated in the last quarter of 2016: presidential elections in the U.S., constitutional referendum in Italy and strong expectations concerning interest rate increase in the U.S. At the end of December the yield on 2-year bonds was 2.04% versus 1.58% at the end of December 2015, the yield on 5-year bonds was 2.89% versus 2.23% at the end of 2015 and yield on 10-year bonds increased from 2.95% at the end of 2015 to 3.63%.

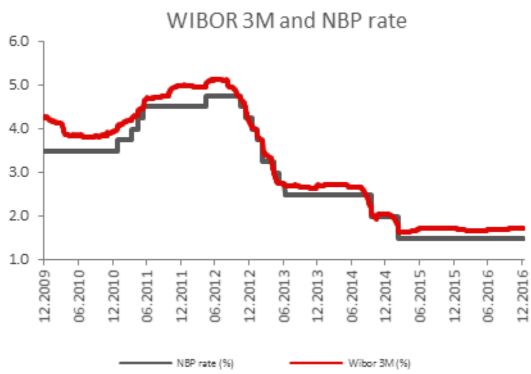
At the end of Q3 2016, public debt amounted to PLN 939.6 billion (51.1% of GDP) vs. PLN 877.3 billion (48.8% of GDP) at the end of 2015.

Exchange rates



In 2016 exchange rates were fluctuating considerably, mainly due to policies followed by key global central banks, i.e. the European Central Bank, the Federal Reserve, Bank of Japan and the Swiss National Bank. Exchange rates were also strongly affected by Brexit referendum and presidential elections in the United States. Britain's decision to exit the European Union and the results of the presidential elections in the United States were highly surprising and caused dramatic changes in currency markets. In the view of deepening deflation in the Eurozone, at the beginning of 2016 the European Central Bank further reduced the deposit rate (after the reduction by 10 p.p. in December 2015) from -0.30% to -0.40%. Other interest rates, including the reference rate, remained unchanged during the entire 2016. In 2016, ECB carried out extensive quantitative easing. Fed, however, have continuously postponed the interest rate increase finally increased the rates in December. Fed raised the rates by 25 b.p. from 0.25-0.50% to 0.50-0.75%. At the same time, Fed intends to continue tightening the monetary policy in 2017 and 2018. Strategies followed by central banks, the results of the Brexit referendum and presidential elections in the United States caused fluctuations in the EUR/USD rates of exchange. Finally, at the end of the year, the American dollar was significantly stronger than then the euro and other currencies, including PLN, comparing to 2015. At the end of 2016 the USD/PLN rate was 4.18, the EUR/PLN rate was 4.40 and the CHF/PLN rate was 4.10. Apart from foreign factors, in 2016 the rate of exchange of the Polish zloty was considerably affected by local circumstances, such as the deterioration of the S&P's rating of Poland and the change of the Moody's outlook to negative in May 2016. Another important factor affecting the PLN rate was the Bill on loans in Swiss francs presented by the Chancellery of the President of the Republic of Poland and the announcement of the plans to amend the bill and the presentation and submission of the Spread Act to the Polish Parliament.

Monetary policy



Source: NBP, Bloomberg

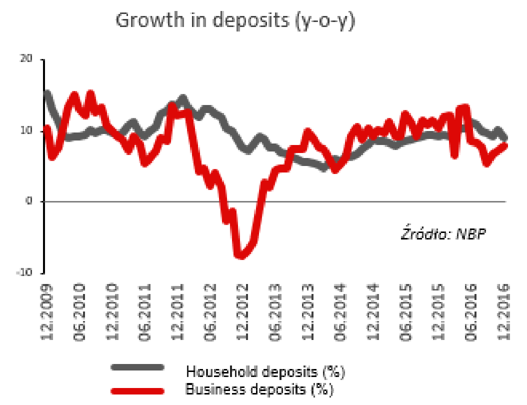
In 2016 the Monetary Policy Council did not change interest rates. Based on CPI and GDP projections prepared by the National Bank of Poland, the Monetary Policy Council expected that deflation would end in 2016 and at the same time it considered the economic slowdown in Poland as a temporary situation related to the delays in utilizing funds from the new EU perspective. At the end of 2016 the reference rate was 1.50%, bill of exchange rediscount rate: 1.75%, Lombard rate: 2.50%, and deposit rate: 0.50%. Unchanged interest rates of the National Bank of Poland translated into stabilization of market rates in 2016. At the end of 2016, WIBOR 3M amounted to 1.73% versus 1.72% at the end of 2015.

Economic ratios	2010	2011	2012	2013	2014	2015	2016
GDP (YoY)	3.9%	4.5%	1.9%	1.7%	3.3%	3.9%	2.8%
Inflation (average for the period)	2.6%	4.3%	3.7%	0.9%	0.0%	(0.9)%	(0.6)%
Registered unemployment rate (at period end)	12.4%	12.5%	13.4%	13.4%	11.5%	9.8%	8.3%
Deposits and other liabilities (PLN billion, at period end)	682.0	761.9	797.9	845.9	914.5	996.0	1,081.8
- Households (PLN billion, at period end)	421.2	478.0	514.9	543.6	591.6	646.0	704.9
- Enterprises (PLN billion, at period end)	181.3	203.3	187.8	206.5	225.9	249.3	269.0
Receivables (PLN billion, at period end)	770.0	880.8	901.1	937.4	1,005.7	1,076.4	1,124.7
Average EUR/PLN rate	3.99	4.12	4.19	4.19	4.18	4.18	4.36
Average USD/PLN rate	3.01	2.96	3.26	3.16	3.15	3.77	3.94
Average CHF/PLN rate	2.89	3.35	3.47	3.41	3.44	3.91	4.00
Reference rate (at period end)	3.50%	4.50%	4.25%	2.50%	2.00%	1.50%	1.50%
WIBOR 3M (at period end)	3.95%	4.99%	4.11%	2.71%	2.06%	1.72%	1.73%

Source: Central Statistical Office, National Bank of Poland, Bloomberg, Reuters

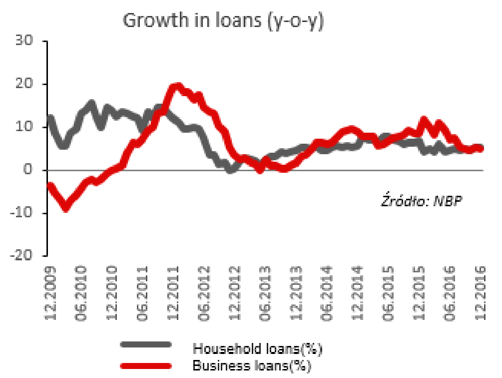
1.2. Situation in the banking sector

Deposits of households and enterprises



At the end of 2016 the total deposits in the banking system amounted to PLN 1,081.8 billion, i.e. by 8.6% more than at the end of 2015. Household deposits stood at PLN 704.9 billion. In 2016, the growth rate of household deposits increased to a double digit number in June (11.2% YoY), which was related to the launch of the Family 500+ program in April. Eventually, in December 2016 the household deposits growth rate stood at 9.1% YoY (versus 9.2% in December 2015). The increase resulted from the launch of the program financially supporting families with children (meeting specific criteria) and the improvement in the labor market. Another deposit driver was deflation reported during the entire year. On the other hand, record low interest rates of the National Bank of Poland still discouraged consumers from depositing funds with banks. In December 2016, deposits of enterprises amounted to PLN 269.0 billion, i.e. increased by 7.9% during the year vs. a 10.4% increase in December 2015. In the first half of the year corporate deposits grew (by 13.1% YoY in May 2016) following the improvement in the financial position of companies and suspended investment processes. Despite the suspension of investment initiatives, in the second half of the year a number of businesses adopted other saving methods than bank deposits.

Loans and advances to households and enterprises



In December 2016, loan receivables in the banking sector totaled PLN 1,124.7 billion, being 4.5% higher than in December 2015. Loans and advanced to households went up by 5.2% to PLN 665.1 billion. Housing loans in the local currency grew from PLN 212.0 billion in December 2015 to PLN 234.4 billion at the end of 2016 (by 10.6%). Record low interest rates and an improvement on the labor market positively affected the scale of the new lending campaign. In the first half of 2016 the Flat for the Young (Mieszkania dla Młodych) considerably increased the demand for mortgage loans among households. Not only was the entire amount for 2016 used, but also a portion of funds for 2017 was disbursed. On the other hand, the down payment was increased from 10% to 15% on 1 January 2016, in accordance with the Recommendation S issued in 2014, which adversely affected the credit appetite. In December 2016 the value of the loan portfolio denominated in foreign currencies dropped to PLN 162.4 billion and was by PLN 3.8 billion lower than at the end of 2015. The decrease in the portfolio value resulted from strategies followed by banks and their clients as a part of the process of restructuring loans in CHF approved by mutual agreement of the parties. Another adverse factor was the implementation of restrictions under Recommendation S, which dramatically impeded taking loans in foreign currencies. In 2016 receivables of the banking sector arising from consumer loans from individuals increased. In December 2016 they totaled PLN 135.4 billion (versus PLN 126.5 billion in December 2015). The consumer loan volume increased due to low interest rates and less stringent credit approval policies followed by banks, which resulted from improvement in the situation on the labor market and higher credit demand of households, the credit standing of which has improved following the launch of the Family 500+ Program. In December 2016 the value of loans granted to enterprises was PLN 344.8 billion as compared to PLN 326.0 billion in December 2015 (5.8% growth). The credit demand of businesses was lower than in previous years, because investment projects were not carried out and the cost of credit for companies increased.

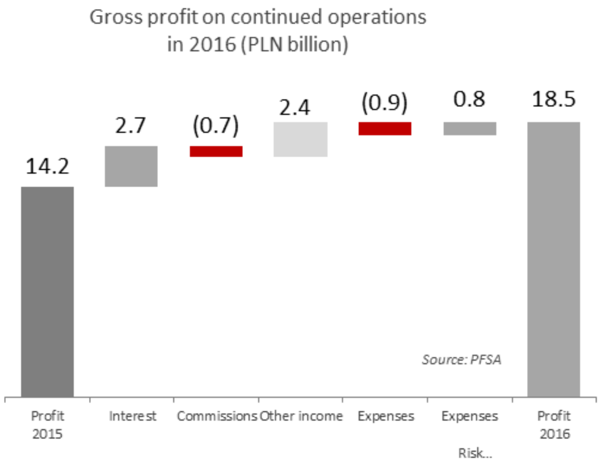
Interest rate on deposits and loans

In 2016 the Monetary Policy Council did not change interest rates. The reference rate remained at a record-low 1.50% and the Lombard rate stood at 2.50%, which materially affected the interest rates on loans and deposits. According to the data of the National Bank of Poland, in December 2016 the average interest rate on new local currency deposits of households amounted to 1.5% versus 1.8% in December 2015. Average interest on new deposits of enterprises was equal to 1.2% as compared to 1.5% in the previous year. Average interest on new loans granted to households in the Polish zloty in December 2016 stood at 6.2%, with no change since the end of 2015. As for loans for households, in December 2016 the interest on housing loans amounted to 4.4% (no change since the end of 2015), and interest on consumer loans reached 7.6% (versus 8.0% at the end of 2015). In the corporate sector, the interest on new loans in the local currency amounted to 3.6%, i.e. the same as in December 2015.

Financial performance of the banking sector

In 12 months of 2016 Polish banks generated the net profit of PLN 13.9 billion, i.e. 24.3% higher than in December 2015. Significantly, since February 2016, performance of a group of banks was adversely affected by endorsement of the Act on tax on certain financial institutions. On the other hand, in the second quarter of 2016, the sale of shares in VISA Europe Limited was finally settled, which improved performance of some banks and, due to the income size, drove performance of the entire banking sector.

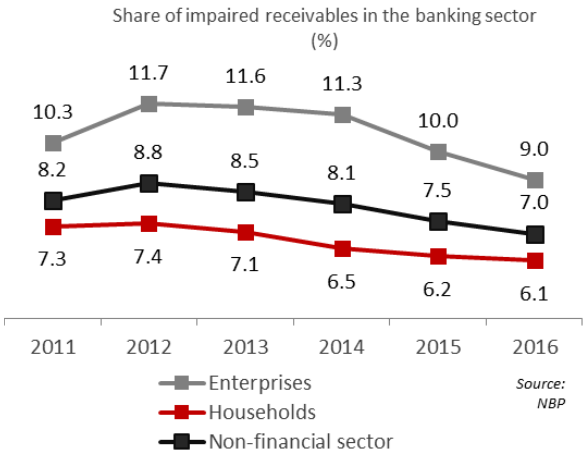
In 2016 the banking sector performance was affected by:



- The increase in the net banking income (by PLN 3.4 billion, i.e. 6.1% versus December 2015), mainly as a result of a marked increase in profit from other banking activities (by PLN 1.5 billion, i.e. 25.2% comparing to December 2015). One of the reasons was the settlement of the sale of shares in VISA Europe Limited discussed above, where following the transactions banks reported an additional income totaling to PLN 2.5 billion. Significantly, the transaction was a non-recurring event and the performance of the banking sector would have been lower if it had not been made. In 2016 the net interest income grew by PLN 2.7 billion, i.e. by 7.6% vs. 2015 as a result of changes in the deposit and credit policies of banks, i.e. reducing interest rates on deposits and at the same time increasing the interest rates on a portion of loans, which eventually increased banks' margins. At the same time, the net fee and commission income decreased in 2016 (by PLN 0.7 billion, i.e. by 5.4% versus 2015), which resulted from the deterioration of revenue from bancassurance services in certain banks, the revenue from loans granted, revenue from maintaining bank accounts and bank cards and the revenue from securities operations, managing investment and pension funds and asset management.
- The increase in operating expense by PLN 0.9 billion, i.e. 2.5% in the period from December 2015 to December 2016 was a consequence of the endorsement of the Act on certain financial institutions, which imposed an additional tax on banks totaling to PLN 3.2 billion.

- A decrease in the negative balance of allowances and provisions of PLN 0.8 billion, i.e. by 10.4% in 2016. Factors which positively affected the balance of impairment losses and provision were: improved situation in the labor market, transfer of cash to households under the Family 500+ program, low interest rates which drove stabilization or improvement of the financial situation of a number of borrowers and the sale of credit receivables to debt collection agencies by selected banks.

The share of impaired receivables in the total receivables from the non-financial sector dropped from 7.5% in December 2015 to a record low level of 7.0% in December 2016[4]. The year 2016 also saw an improvement in the quality of credit exposures of banks to enterprises and households and certain banks sold their credit exposures to external companies.



Banks retained a large portion of profits generated in 2015 and refrained from or suspended dividend payment, hence the capital base strengthened (the increase in equity from PLN 159.1 billion at the end of 2015 to PLN 162.0 billion at the end of December 2016) and the total capital ratio increased from 16.3% in December 2015 to 17.4% in December 2016. In December 2016 Tier 1 ratio amounted to 15.9% versus 15.0% at the end of 2015.

In 2016 banks focused on improving efficiency by way of optimizing human resources and the sales network. The process was driven by earlier mergers and acquisitions and development of online banking services. Consequently, the number of persons employed in the banking sector dropped at the end of December 2016 by 2.1 thousand people and the sales network was reduced by 29 outlets.

1.3. Capital market

Stock market (WSE main market and ASO New Connect market)

The year 2016 saw an increase in key indices of the Warsaw Stock Exchange (WIG and WIG20). WIG20 grew by 4.77% up to 1,947 points and WIG by 11.38% up to 51,754.03 points. At the end of December 2016 the value of Polish firms listed at the Warsaw Stock Exchange reached PLN 557.1 billion and was by 7.8% higher than in December 2015. The number of IPOs dropped from 30 in 2015 to 19 in 2016 and was the lowest number of IPOs in the last three years.

Investors were less active as well. In 2016 shares worth PLN 189.2 billion changed hands as a result of session transactions, i.e. by 7.5% less than in the previous year.

[4] Data of the National Bank of Poland, monetary and financial data, File: Receivables.

Investment funds' net assets

In 2016 the growth rate of Polish investment fund assets amounted to 2.7% as compared to 21% in 2015. Cash inflows were observed in the first half of 2016 (net inflows of PLN 9.7 billion and an increase in the total assets up to PLN 261.9 billion), while in the second half of the year outflows prevailed[5].

1.4. Macroeconomic factors potentially affecting the Group's performance

Internal demand will remain main driving force of Polish economy in year 2017

GDP growth by 3.2-3.5%

According to the Bank, the macroeconomic situation shall slowly but steadily improve in 2017, although external factors may cause uncertainty. The economic growth rate should increase to 3.2-3.5% of GDP. Domestic demand will continue to grow, while the Russian import ban on agricultural products and foods, slow economic growth in the Eurozone, initiation of the Brexit process and possible trade wars between the United States and other countries may limit the growth in exports of goods and services. An increase in domestic demand shall result from a growth in both consumption and investments. An advantageous situation in the labor market (an increase in salaries and wages and employment rate) and cash transfers to families with children under the Family 500+ program (ca. PLN 23 billion in 2017) are likely to drive consumption expenditure. Consumption may also be boosted by higher appetite for consumer loans among households due to their improved credit standing. Households may be also discouraged to increase consumption expenditure by inflation. Still, assuming that the inflation growth will be moderate only, it should not result in a considerable reduction of expenditure. After the decrease in 2016 resulting from delays in disbursements of funds under the EU perspective 2014-2020, investment expenditures are expected to grow in 2017. Record low interest rates should also positively affect investments in the economy. The Bank expects that at the end of 2017 the reference rate of the National Bank of Poland will remain at 1.50%.

In 2017 other challenges for the Polish banking sector and for the Group may include:

- Possible changes in tax on certain financial institutions (the bank tax) after the expected review by the Ministry of Finance.
- Possible regulations which would prohibit charging fees for maintaining accounts and making card transactions.
- Implementation of recommendations of the Financial Stability Committee on restructuring mortgage loans denominated in foreign currencies including the Swiss franc. The Committee recommended increasing the risk weight to 150% and maintaining a system risk buffer of 3%. If capital requirements are increased for banks, their ability to extend new loans may be reduced and the risk buffer may become a serious burden for the entire banking sector. Conversion of mortgage loans in Swiss francs will not directly affect the Bank, as all mortgage loans in its portfolio have been granted in Polish zloty.
- Possible deterioration of Poland's perception by investors and capital outflow resulting from adverse changes in ratings assigned to Poland by rating agencies. After S&P cut Poland's long-term foreign currency sovereign credit rating from A- to BBB+ on 15 January 2016, which was the first downgrade since 1995 and when Moody's changed the rating outlook to negative in May, further downgrades by rating agencies are possible. Agencies emphasized the percentage of the public deficit in GDP, which was estimated by the Ministry of Finance at 2.8-2.9% in 2016, i.e. much above the projections and close to 3.0%, the amount determined by the EU. According to rating agencies, state pension age reduction in Poland, which will come into force as of 1 October 2017, may also adversely affect the rating. Any downgrade of the rating or outlook would result in a weaker zloty against all major currencies and the sale of domestic treasury bonds.
- GDP growth rate lower than projected due to delays in investments in the economy. If the actual growth is slower than expected, the operational risk of banks may increase and the loan portfolio quality may deteriorate.
- Possible deterioration of the situation in the global economy. The Brexit process will have been formally launched by the end of March 2017, which may bring about economic turbulence in the United Kingdom and in the whole

[5] Source: fund assets; data of the Chamber of Fund and Asset Management.

European Union. Moreover, the policies of the President of the U.S., Donald Trump, and possible trade wars between the U.S.A. and its key trade partners, in particular China, may dramatically affect the world economy. The problems of Greece and other Southern European countries (including the Italian banking sector) remain unsolved, the economic rebound in the Eurozone seems moderate. This scenario could adversely affect Polish exporters and could hinder the economic growth rate. This, in turn, would entail a limited demand for services offered by the Bank and higher costs of risk related to the deterioration of the financial position of clients.

- Fed discontinuing its easement policy sooner than expected. It could translate into capital outflow from emerging markets, including from Poland. The Polish currency would weaken and Treasury securities would be sold. It would also lead to higher costs of servicing public debt and limited possibility to finance business investments.
- Further reduction of interest rates by Swiss National Bank (SNB). Although this would reduce the value of CHF vs. other currencies, to include PLN, and improve lenders' ability to pay their liabilities to banks, LIBOR CHF rates getting more and more negative would affect banks holding large portfolios of CHF-denominated loans.

1.5. Regulatory environment

In 2016, the financial and organizational condition of the Group was affected by the following amendments of law:

Regulation	Change description	Project impact on the Group
Act of 9 October 2015 amending the Banking Law and certain other acts.	The key objective of the Act was to provide regulations concerning inactive (dormant) accounts. The changes concerned the impact of the account holder's death on the account agreement, and their objective was to provide easier access to the account for his heirs, legatees, and therefore eliminate problems faced by legal hairs in the process of collecting inherited funds and to implement appropriate legal tools.	System changes.
Recommendation of the Polish Financial Supervision Authority concerning securing of online payments made by banks, national payment institutions, national electronic money institutions and credit unions.	The objective of the Recommendation is to provide standard minimum requirements for secure online payment services provided by banks, national payment institutions, national electronic money institutions and credit unions. The Recommendation covers the following areas: - Principles and administration of risk management and assessment; - Controls and security measures applicable to online payments; - Customer communication and education.	System changes.
Recommendation W concerning risk management models in banks issued by the Polish Financial Supervision Authority.	The Recommendation discusses model risk management and determines model risk management standards with the process framework, the principles of modeling and assessing model quality in compliance with corporate governance standards.	Corporate governance.
Recommendation C concerning concentration risk management issued by the Polish Financial Supervision Authority.	The Recommendation implements changes in the concentration risk management principles.	Credit risk.
Act amending the act on supervision over the financial market and certain other acts of 5 August 2015.	Key changes concern the amount of payments for defaulting under timely repayment of the principal or interest.	Revenue of the Group.

Regulation (EU) of the European Parliament and of the Council of 16 April 2014 on market abuse (MAR).	The regulations sets out new principles of informing and reporting by issuers of securities.	System changes.
The Act on tax on certain financial institutions of 15 January 2016.	The act imposes tax on assets of certain financial institutions, including banks.	Expenses of the Group.
The Act of 9 October 2015 amending the act on payment terms in business dealings, the Civil Code and certain other acts entered into force on 1 January 2016.	The Act changed the method of calculating statutory and maximum interest. The new system is based on the reference rate of the National Bank of Poland instead of the Lombard loan rate. If the interest amount does not result from any acts in law, statutory interest is applied and calculated as: the reference rate of the National Bank of Poland (at present equal to 1.5%) + 3.5%. Maximum interest on acts in law may not exceed twice the amount of statutory interest (10% now) per annum. The Act also specifies maximum default interest. If it has not been specified it should be equal to the reference rate of the National Bank of Poland (1.5%) plus 5.5%. If the interest on a loan is higher, the creditor may demand higher default interest. Maximum default interest may not exceed twice the amount of statutory default interest (14% now).	System changes, Group revenue.
Resolution No. 25/2015 of the Bank Guarantee Fund Council of 25 November 2015 determining the rate of the 2016 annual fee payable to the Bank Guarantee Fund by entities subject to the obligatory guarantee system.	The Bank Guarantee Fund Council determined the rate of the 2016 annual fee payable to the Bank Guarantee Fund by entities subject to the obligatory guarantee system at 0.167% of the total risk exposure amount specified in the Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending the Regulation (EU) No. 648/2012, calculated in line with the provisions of this resolution and the Act of 29 August 1997- the Banking Law.	Expenses of the Group.
Resolution No. 26/2015 of the Bank Guarantee Fund Council of 25 November 2015 on determining a prudential fee for 2016 payable to the Bank Guarantee Fund by entities subject to the obligatory guarantee system.	The Bank Guarantee Fund Council determined the prudential fee for 2016 payable to the Bank Guarantee Fund by entities subject to the obligatory guarantee system at 0.079% of the total risk exposure amount specified in the Regulation of the European Parliament and of the Council (EU) No. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending the Regulation (EU) No. 648/2012, calculated in line with the provisions of this resolution and the Act of 29 August 1997- the Banking Law.	Expenses of the Group.

Moreover, works and negotiations have been carried out on the following regulations:

Regulation	Change description	Projected impact on the Group
Draft ordinance of the Minister of Finance on the risk management system and internal	The draft ordinance sets out risk management principles at the Bank, positions, outlines core principles for internal	Organizational changes.

controls, remuneration policy and detailed methods of measuring internal capital.	audit and compliance and refers to the principles of developing remuneration policies.	
Draft amendment to Recommendation H of the Polish Financial Supervision Authority concerning the internal control system at banks.	Amendment to Recommendation H assumes: - creating an internal control system based on internal controls which ensure meeting statutory requirements (i.e. the effectiveness and efficiency of bank operations, financial reporting reliability, compliance with the risk management principles, compliance with the applicable laws, internal regulations and market standards) to replace the functional control-based approach; - treating an internal control system as a system independent of the risk management system, creating a compliance and internal audit unit in the internal control system; - including the internal control system in the three lines of defense model.	Organizational changes.
Recommendation Z concerning corporate governance issued by the Polish Financial Supervision Authority.	The Recommendation concerns the principles of internal management in banks. It will regulate the following areas: organizational structure, tasks, obligations, composition and activities of the supervisory board, management board, top executives, risk and internal control management, IT systems and communication, going concern and management transparency in the bank.	Corporate governance.
Act of 30 November 2016 amending the act on payment services.	From the Bank's point of view important regulations are those related to: - presentation to consumers (before entering into agreement) a document including the list of services rendered and related fees charged ("comparable information") and a cyclical list of fees for services related to the payment account (prepared at least annually); - ensuring access to the basic payment account; - enabling transfer of a payment account on terms specified in the act. Banks are obliged to comply with the requirements in question not later than within 18 months of the date the act entered into force, i.e. by 8 August 2018.	System changes.
MiFID II/MIFIR.	MiFID II and MiFIR (Markets in Financial Instruments Directive / Regulation) impose new requirements on financial market entities concerning investor protection (e.g. new product governance requirements, more stringent incentive requirements, including structured products into the scope of MiFID II, adjusting the principles of communicating with customers and introducing new information requirements, including those related to costs), market transparency (e.g. more detailed reporting requirements concerning transactions and corporate governance and wider powers granted to supervisory authorities (including those related to product interventions).	System and organizational changes.

Act of 15 December 2016 amending the accounting act	The act requires that large public-trust entities, including the Bank, disclose non-financial information (social, employee, environment, human right and anti-corruption issues) in their reports on the activities.	New reporting requirements.
The Act of 10 June 2016 on Bank Guarantee Fund, deposit guarantee system and statutory restructuring with secondary legislation.	The act imposes new disclosure requirements on the Bank with respect to information provided to the Bank Guarantee Fund and the Bank's clients. Implementing acts thereto detail reporting requirements concerning information provided to the Bank Guarantee Fund and the change of the method of determining fees paid by banks.	New disclosure and reporting requirements, costs of the Group.

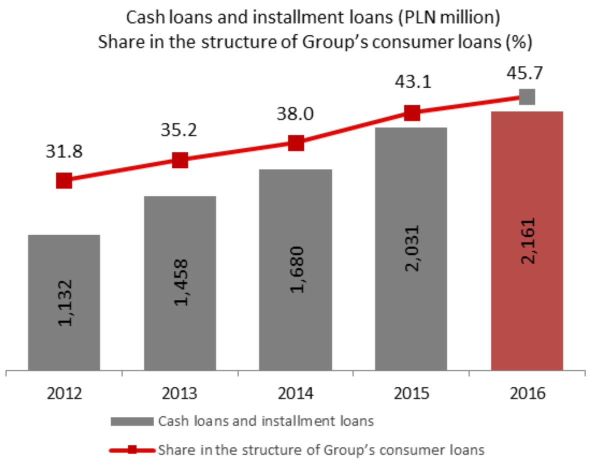
Bank Pocztowy

2. Significant Events in the Capital Group in 2016

2.1. Continued growth in cash loans and installment loans

In 2016 the Group followed the balance sheet optimization strategy aimed at increasing the share of more profitable assets, i.e. cash loans and installment loans, which have become flagship products of the Group. At the end of December 2016 the total value of cash loans and installments loans reached PLN 2,161.3 million, having grown by PLN 130.1 million, i.e. 6.4% since December 2015.

In line with the strategy adopted, in 2016, like in preceding years, the Group was changing its credit exposure structure to improve the interest yield, i.e. grow the share of cash loans and installment loans and reduce the proportion of loans to institutional clients and real estate loans.



Loans and advances granted to customers of the Bank Pocztowy S.A. Capital Group (PLN'000)						
	31.12.2016	Structure (31.12.2016)	31.12.2015	Structure (31.12.2015)	Change 2016/2015 PLN '000	%
Gross loans and advances granted to customers	**5,472,152**	**100.0%**	**5,542,489**	**100.0%**	**(70,337)**	**(1.3)%**
individuals, including:	4,734,032	86.5%	4,711,355	85.0%	22,677	0.5 %
cash loans and installment loans	2,161,347	39.5%	2,031,277	36.7%	130,070	6.4 %
mortgage loans	212,847	3.9%	228,598	4.1%	(15,751)	(6.9)%
real estate loans	2,314,454	42.3%	2,402,034	43.3%	(87,580)	(3.6)%
overdraft facilities	28,857	0.5%	32,478	0.6%	(3,621)	(11.1)%
credit card debt	16,527	0.3%	16,968	0.3%	(441)	(2.6)%
institutional customers	532,574	9.7%	578,292	10.4%	(45,718)	(7.9)%
local government	205,546	3.8%	252,842	4.6%	(47,296)	(18.7)%
Impairment losses on receivables	**317,813**		**229,607**		**88,206**	**38.4 %**
Net loans and advances	**5,154,339**		**5,312,882**		**(158,543)**	**(3.0)%**

Lower balances of loans granted to institutional clients and local government institutions reported in 2016 resulted from a strategic decision of the Group to change the credit policy in this respect and reduce financing extended to these client groups.

2.2. Growth of deposits of consumers

At the end of December 2016 the total Group's liabilities to clients reached PLN 5,763.0 million having grown by PLN 20.6 million (i.e. 0.4%) since December 2015. During the year, liabilities to consumers increased by 5.9%, i.e. by PLN 260.9 million and on 31 December 2016 their balance was PLN 4,705.7 million. The amount of funds deposited on current accounts (mainly on saving and settlement accounts) of consumers increased to reach PLN 2,797.8 million at the end of December 2016 (13.1% more than in December 2015).

Liabilities to customers of the Bank Pocztowy S.A. Capital Group (PLN'000)						
	31.12.2016	Structure (31.12.2016)	31.12.2015	Structure (31.12.2015)	Change 2016/2015 PLN '000	%
Liabilities to customers	**5,763,014**	**100.0%**	**5,742,377**	**100.0%**	**20,637**	**0.4 %**
Retail customers	4,705,730	81.7%	4,444,874	77.4%	260,856	5.9 %
Institutional customers	1,019,498	17.6%	1,247,743	21.7%	(228,245)	(18.3)%
Government agencies and local governmen	37,786	0.7%	49,760	0.9%	(11,974)	(24.1)%

In 2016 the Group tried to reduce the sale of deposits of institutional clients, government and local government entities with negotiated high interest rates due to the growing portfolio of consumer deposits, which are more stable. The Group adjusted the balance of deposits to its liquidity needs and a strategic decision to reduce the acquisition of deposits in this client group. Consequently, the balance of deposits of institutional clients decreased by 18.3% and those of government and local government entities - by 24.1%.

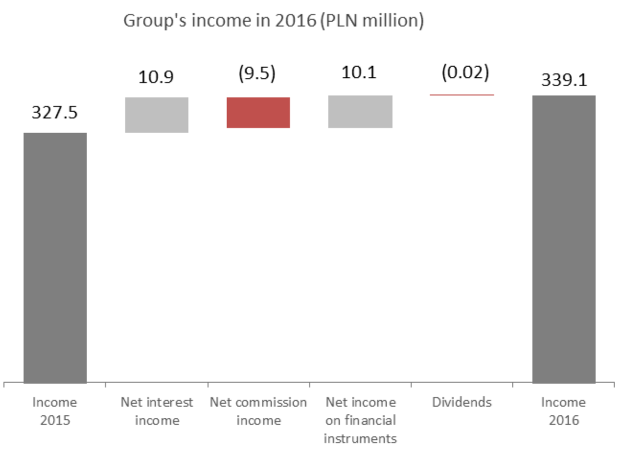
2.3. Increase in the operating income

In 2016 the Group operated in a disadvantageous environment of low interest rates, which have not changed since March 2015. Additionally, the Group's financial performance was adversely affected by the bank tax imposed on 1 February 2016 in line with the Act on tax on certain financial institutions of 15 January 2016, Journal of Laws of 2016, item 68). The bank tax applies to domestic banks, foreign bank branches, branches of credit institutions, credit unions, domestic insurance and reinsurance companies and branches and major branches of foreign insurance and reinsurance companies and lending institutions. The act imposed a tax rate of 0.44% p.a. on banks with the taxable amount equal to the month-end balance of assets in excess of PLN 4 billion less equity and treasury securities. In 2016 the Group incurred expenditure related to this tax amounting to PLN 4.8 million.

Despite disadvantageous market environment, in 2016 the Group generated income of PLN 339.1 million, i.e. 3.5% more than in 2015.

Higher income was generated mainly due to:

- An increase in the net interest income by 4.2% mainly due to efficient optimization of cost of deposits (in 2016 average cost of deposits amounted to 0.93% versus 1.26% in 2015) and the growing share of cash loans and installment loans with the highest interest yield in the loan portfolio.
- A decrease in the net fee and commission income by 16.5%, mainly due to the recognition of additional provisions for possible claims resulting from the pending proceedings instigated by the President of the Office for Competition and Consumer Protection ("UOKiK") on 4 December 2015 to determine if the Bank employed practices violating collective consumer interests.



- Higher gain on transactions in securities available for sale, gain on foreign exchange transactions and gain on other financial instruments. The total income on such transactions amounted to PLN 23.6 million, i.e. by 10.1 million more than in 2015 mainly as a result of settling the sale of shares in VISA Europe to VISA Inc. under the acquisition of VISA Europe by VISA Inc., as a result of which the Group generated income of PLN 16,872 thousand, including:
  - PLN 12,244 thousand in cash;
  - PLN 3,592 thousand of income from preference C series shares convertible to ordinary A series shares in Visa Inc.;
  - PLN 1,036 thousand of income from the Group's share in the deferred cash payment.

2.4. Bond issues

Translation Bank Pocztowy Bonds; Safe Polish Bank; Check

The Bank has consistently followed its policy of diversifying sources of finance, by way of developing its activities in the treasury bond markets.

On 23 December 2015 the General Shareholders' Meeting of the Bank approved a public issue of bonds scheme up to a maximum face value of issued and outstanding bonds of PLN 1,000,000,000.

- Bonds will be issued under a public offering with and without an obligation to produce a prospectus (Article 33.1 of the Act on bonds) and a private placement (Article 33.2 of the Act on bonds);
- Bonds may be issued in one or many series as: (i) ordinary bonds or (ii)subordinated bonds in accordance with Article 22 of the Act on bonds and Article 127 of the Banking Law;
- All bonds issued will be unsecured;
- Bonds will take the form of a document and they will be recorded in the register kept by the entity designated by the Management Board of the Bank or the securities deposit maintained by Krajowy Depozyt Papierów Wartościowych S.A. or from the issue date they may be recorded in the register and then reregistered to the securities deposit kept by Krajowy Depozyt Papierów Wartościowych S.A.;
- The Management Board will request for admitting the bonds for trading on the regulated market of the Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.) in the Catalyst system.

At the same time, the Management Board authorized the Bank to determine final terms of issue of individual bond series, terms of bond allotment to investors and any actions taken to carry out the Issue Scheme.

On 16 May 2016, the Polish Financial Supervision Authority approved the prospectus of the Bank.

On 8 June 2016 the Bank issued P1 series subordinated bonds under the Public Issue of Bonds Scheme. The total face value of P1 series bonds is PLN 50,000 thousand. Bonds bear a floating interest rate equal to the sum of WIBOR 6M base rate and a margin of 2.8% p.a., starting from the second interest period. In the first interest period the interest rate was 4.5% p.a. Bonds redemption date falls in 2026. For the first time, the bonds are intended for individual investors.

On 23 June 2016, the Bank obtained PFSA's consent to include PLN 50,000 thousand constituting a subordinated liability under the issue of the P1 series subordinated bonds in the calculation Tier 2 capital. Consequently, the Bank strengthened the capital ratios and provided a safety buffer against the equity requirements of PFSA. The Bank will be able to dispose of funds from the bond issue at its own discretion, in particular it may allocate them to finance current operations and grow lending activity.

On 8 July 2016 the Bank prematurely redeemed 4,734 subordinated bearer bonds with the total face value of PLN 47,340 thousand, assigned a code PLBPCZT00015 by Krajowy Depozyt Papierów Wartościowych S.A. (National Deposit of Securities) and quoted in the Catalyst alternative trading system operated by Warsaw Stock Exchange under the abbreviated name BPO0721.

On 30 August 2016, the Bank decided to register 500,000 subordinated P1 series bearer bonds of the Bank with the face value PLN 100 (one hundred zloty) each in the securities deposit and assign them a code PLBPCZT00080. Bonds were registered on 1 September 2016.

The Management Board of Giełda Papierów Wartościowych w Warszawie S.A. (Warsaw Stock Exchange) decided that 8 September 2016 will be the first day of trading of 500,000 P1 series bearer bonds with the face value of 100 each assigned a code PLBPCZT00080 by the National Deposit of Securities in the Catalyst alternative trading system. The bonds will be traded in the continuous trading system under a shortened code "BPO0626".

On 13 December 2016, pursuant to the Terms of Issue, the Bank redeemed 14,785 ordinary B2 series bearer bonds with the face value of PLN 147,850 thousand. The B2 series bonds were traded in the Catalyst alternative trading system of the Warsaw Stock Exchange (Catalyst).

Until then the Bank was present in the debt market for institutional investors, where it had issued long-term bonds with the value exceeding PLN 800 million in the last few years.

The Bank provided detailed information on the issue of bonds in its current reports, which are available at the website of the *Catalyst* market and of the Bank at *www.pocztowy.pl.*

2.5. Awards and distinctions

In 2016 the Group earned a number of awards expressing appreciation for the development of the product offer and efficient implementation of the strategy. Individual awards were also granted to the Bank's experts and managers.

The market appreciated a simple and clear offer of the Bank. The cash loan offered by the Bank took the second place in the May ranking of Comperia.pl. The ranking survey was carried out among Fast50Club[6] users and concerned key product parameters.

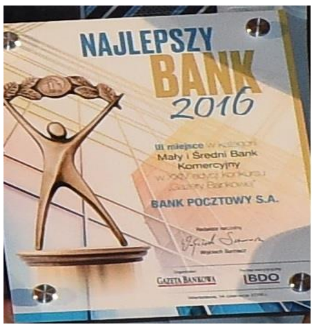
The Bank's cash loan was ranked second by TotalMoney.pl in the category of cash loans up to PLN 5 thousand for internal clients. The Bank also came second in the category of cash loans for external clients. In the TotalMoney.pl ranking banks prepared a pricing offer for a loan of PLN 10,000 with a 24-month tenor for a three person family with a net monthly income of PLN 4,423 earned under an indefinite employment contract. The offers for internal and external clients were compared. The ranking included the offer of 17 creditors.

In 2016, for the second year in a row, the cash loan, i.e. the flagship product of the Bank received a Portfel "Wprost" award in the personal loans category. This prestigious award is given to financial institutions offering most innovative and competitive products and services which most adequately respond to client needs. The project is carried out under the patronage of the Minister of Treasury.

Pocztowe Konto 500+ (Postal Bank Account) with a 4% interest rate for new cash up to PLN 5 thousand received a Camperia Stars award and it was selected as the best saving account in the Comperia.pl ranking twice (in April and May 2016).

The Bank took the fifth place in the survey analyzing the Customer Service Quality in Remote Banking, organized for the fifth time by MojeBankowanie.pl. The award is all the more valuable, as the Bank reported the largest progress among all survey participants, improving its performance by 19 p.p. in the last 12 months. This implies an advancement by 23 places.

Moreover, the Bank was ranked one of the top three mediation-friendly financial institutions. The "Mediation-Friendly Financial Institution" title was awarded to the Bank by the Polish Financial Supervision Authority in 2015. The competition had been launched two years ago. In accordance with the resolution of the Polish Financial Supervision Authority the award is granted to financial institutions which publicly declare their intention to resolve disputes amicably through mediation and at the same time in a given calendar year they agreed to mediation by the Mediation Center of the Court of Arbitration at the Polish Financial Supervision Authority or managed to settle a dispute amicably before any mediation proceedings were instigated for over 30 percent of requests for mediation put in by clients. The award may also be granted if a financial institution requested for mediation concerning at least 10 requests and at the same time agreed on mediation in the Mediation Center of the Polish Financial Supervision Authority.



The Bank came third in the twenty fourth round of the competition held by the Gazeta Bankowa monthly and the National Bank of Poland in the Small and Medium Commercial Bank category. It was appreciated for its good performance in 2015 in the following categories: dynamic growth, portfolio structure and efficiency.

The Bank came third in the bank customer satisfaction survey carried out by the Parkiet daily and got 3.6 points in the five-point scale, which is much above the average result of 2.6. This award is highly satisfying, because it was given by

[6] *Fast50Club is a platform associating people interested in pro-active and efficient saving*

clients, whose opinions were used to create the ranking. Moreover, customers also appreciated competencies of our Relationship Managers, easy access to accounts and services with as little bureaucracy as possible.

The Bank got three awards in this year's edition of the prestigious The Best Annual Report 2016 contest organized by the Institute for Accounting and Taxes and the Warsaw Stock Exchange. The Annual Report of the Bank Pocztowy Capital Group for 2015 was the winner in the category Best Annual Report of a bank or a financial institution. The Bank was also recognized for the best financial statements and the greatest progress in improving a marketing report. The first place in this prestigious competition is a great distinction and a way of acknowledging the top quality of the Bank's financial reporting. The standards applied by the Bank, transparency and the practical value of annual reports make the Bank one of the best companies in this respect among those not listed at the WSE (apart from Catalyst).

Ms. Magdalena Nawara was selected as one of the TOP 10 female managers in the Polish capital market. Magdalena Nawara and other top managers were selected to "TOP 10 women of the financial market" by Internet users observing the Polish financial market.

The Chief Economist, Ms. Monika Kurtek, was ranked third in the competition for the best macroeconomic analysts organized by the Rzeczpospolita and Parkiet dailies in cooperation with the National Bank of Poland. The award committee also granted awards for the most accurate forecasts for the Polish economy in 2015. To become one of the top macroeconomic analysts, at each quarter-end participants submitted forecasts for the following four months for key macroeconomic indicators: change in GDP, investments, CPI, unemployment rate and the country's current account. All forecasts were awarded a specific number of points for their accuracy. On this basis top Polish economists were selected from among 42 participants.

The Managing Director of the Legal and Administration Function, Jolanta Ciążyńska-Syka received an Honorable Award from the Polish Banks Association granted to people, whose creative work and effort shaped the Polish banking sector.

3. Activities in the Consumer Market

3.1. Consumers

In 2016 the Bank acquired 158 thousand new consumers and microenterprises, mainly thanks to the ZawszeDarmowe account with the fee maintenance guarantee.

158

thousand new retail customers

In year 2016

At the end of 2016, services offered by Bank Pocztowy were used by 1,309.9 thousand consumers (individuals and microenterprises), i.e. 174.3 thousand less than a year before. The number of customers decreased as a result of a review of the Bank's accounts, when the Bank closed dormant saving and current accounts. Under Article 60 of the Banking Law the Bank closed inactive accounts with no transactions reported other than interest accrual and with the cash balance of less than PLN 200. Consequently, the customer portfolio has become more accurate and realistic.

3.2. Development of the product offer for consumers

The Bank has created a simple and comprehensible offer for consumers, including deposit, credit, investment, and insurance products.

At the end of 2016 the offer covered the following product groups:

- current account (Pocztowe Konto ZawszeDarmowe);
- saving accounts (Pocztowe Konto Oszczędnościowe and Pocztowe Konto 500+);
- fixed-rate term deposits: short-term MINI, mid-term MIDI, and long-term MAXI, i.e. as at 31 December 2016 it was respectively: 4, 6 and 36 months;
- floating-rate term deposits based on WIBID 3M – Market + 30M;
- 3-month unit-linked deposit;
- cash loans, revolving overdrafts and credit cards;
- mortgage loans (including housing loans, mortgage loans and debt consolidation loans);
- insurance;
- investment funds.

A current account for consumers is the key product used for acquiring consumers.

Encouraging its clients to pro-actively use Pocztowe Konto ZawszeDarmowe, in April 2016 the Bank launched an "Unlimited Benefits" Program, which enables making any account operations with no additional charges apart from the monthly maintenance fee. Key transactions included in the program are domestic transfers ordered through any channel, including immediate transfers and Sorbnet transfers; cash withdrawals from any ATM in Poland and abroad and cash delivery to any address through a postman. Moreover, to welcome new clients and encourage them to pro-actively use the account from the very first days, the Bank launched the onboarding process for new *ZawszeDarmowe* account holders. The program objective is to present account functionalities to consumers and special schemes and offers.

Translation Unlimited benefits within account

To expand the functionalities of current accounts, the Bank offers immediate transfer services through Pocztowy24 online banking and Contact Centre. The new offer was highly appreciated by consumers, who made 45 thousand immediate transfers during the first six months of the offer launch.

In 2016 the deposit offer for consumers remained stable, i.e. the Bank continuously offered products well known to its customers, such as MINI, MIDI, MAXI, Lokata Rynek+ 30M and Pocztowe Konto Oszczędnościowe.

The investment funds' offer constitutes and interesting alternative to the deposit offer for clients with a higher risk appetite. Since January 2015 the Bank, in cooperation with Ipopema TFI, has offered the possibility to purchase units in selected investment funds with a various investment strategy and risk profile. Investment products are available in the Bank's sales network only.

In 2016, a number of changes were made in the product offer of investment funds. In July 2016 the Bank launched white label funds under the name "Pocztowy SFIO", which comprised the following sub-funds: Pocztowy Ostrożny (Postal Bank Prudent Fund) and Pocztowy Zrównoważony (Postal Bank Balanced Fund).
In the following months of 2016 the following changes were made to the Pocztowy SFIO offer:

- the name of the "Pocztowy Ostrożny" subfund (Postal Bank Prudent Fund) was changed to "Pocztowy Stabilny" (Postal Bank Stable Fund);
- "Pocztowy Gotówkowy" subfund (Postal Bank Cash Fund) was launched;
- "Pocztowy Zrównoważony" (Postal Bank Balanced Fund) was replaced with the "Pocztowy Obligacji" (Postal Bank Bond Fund).

In the "IPOPEMA SFIO" portfolio two products from the Bank's offer are no longer available: "Ipopema Gotówkowy" (Ipopema Cash Fund) and "Ipopema Obligacji" (Ipopema Bond Fund).

"IPOPEMA SFIO" was replaced with "Pocztowy SFIO" in "Lokata z Funduszem" (Unit-linked Deposit). Consequently, the product offers one subfund only ("Pocztowy Stabilny").

Steps were taken to improve security of clients acquiring participation units in investment funds: the processes of customer segmentation and presales (welcome call) have been enhanced. Moreover, the training program, including introductory training, has been extended to maximally improve competencies of Relationship Managers.

The Bank also offers bancassurance products in cooperation with insurance companies, such as: Pocztowe Towarzystwo Ubezpieczeń Wzajemnych, Aviva Towarzystwo Ubezpieczeń na Życie S.A., Aviva Towarzystwo Ubezpieczeń Ogólnych S.A. and Pocztowe Towarzystwo Ubezpieczeń na Życie.
The insurance coverage for borrowers using cash loans did not change in 2016 and includes unemployment insurance, accident insurance and life insurance. The offer for mortgage loan borrowers and current account holders has remained unchanged. The Bank offers real estate insurance and life and unemployment insurance packages.

In 2016 the Bank worked on changes in the bancassurance offer related to cash loans, i.e. it prepared a table of charges depending on the age, sum insured and the risk of individual clients and changes in the insurance documentation. It also worked with insurance companies to adjust the insurance documentation to changes in the Act on out-of-court settlement of disputes.

Moreover, the Bank pro-actively participates in the government program "Rodzina 500 plus" and in April 2016 it offered the possibility for consumers to request for care allowance under the "Rodzina 500 plus" program in the online channel Pocztowy24. In view of the needs of the beneficiaries, it launched a Pocztowe Konto 500+ (Postal Bank Account 500+) which allow for saving funds for larger future expenditure at an attractive interest rate of 4% p.a.

In March 2016 the Bank modified its process of applying for cash loans to enable tailoring the credit offer to individual client needs. Counteroffer, i.e. a tool presenting the best offer for a client suggests credit parameters (interest, fee, tenor and loan amount) tailored to the needs of a given borrower, taking into account his credit history and financial standing.

In the first half of 2016 the Bank introduced changes to the risk classes and price matrices in the cash loan approval process. Now the price is determined individually based on product characteristics and customer details which are also considered by the Bank. The change enabled the Bank to more adequately adjust price parameters to requesting borrowers.

In late July and early August the Bank modified the terms of Pożyczka na Poczcie (Post Office Loan). The product terms were modified, i.e. a maximum loan amount has been increased to PLN 3,500, the maximum tenor has been increased from 12 to 48 months and the maximum amount granted based on a statement of means only has been increased from PLN 1,000 to PLN 3,500. At the same time the product pricing has been changed. Zero interest rate and a fixed fee have been replaced by a new price and terms of charging fees applicable to cash loans.

The new Post Office Loan was promoted vigorously.

In 2016 the Bank carried out a project implementing the New Cash Loan Approval Process. In line with the Bank's assumptions, the process is simple, easy and intuitive - user-friendly and motivating for Relationship Managers, but at the same time safe for the Bank. Apart from the technological process, other elements, such as the product and credit risk were modified to provide an optimal comprehensive solution. The implementation of the new process was planned for the end of the first quarter of 2017.

3.3. Credit operations

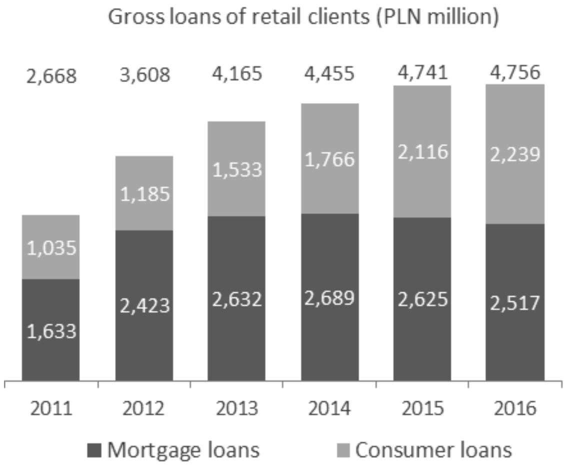
At the end of 2016 gross credit receivables of Bank Pocztowy from consumers totaled PLN 4,756.5 million versus PLN 4,741.3 million in December 2015 (a 0.3% increase). The Bank's share in credit receivables from consumers in the banking sector amounted to 0,8%[7].

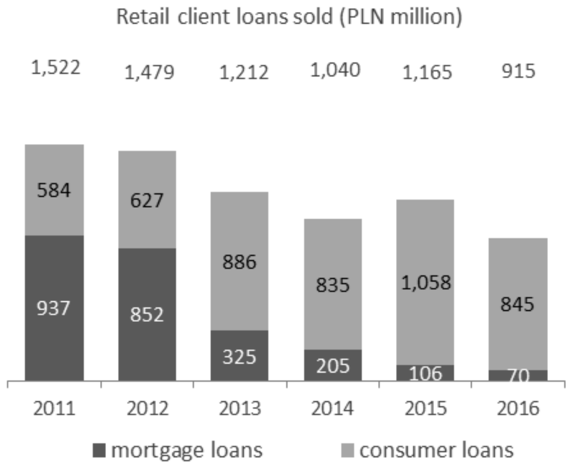
Gross loans granted to customers of Bank Pocztowy S.A. in the retail segment (PLN'000)

	31.12.2016	Structure (31.12.2016)	31.12.2015	Structure (31.12.2015)	Change 2016/2015 PLN '000	%
Gross loans and advances, including	**4,756,471**	**100.0%**	**4,741,255**	**100.0%**	**15,216**	**0.3 %**
Mortgage loans	2,517,278	52.9%	2,625,126	55.4%	(107,848)	(4.1)%
Consumer loans	2,239,193	47.1%	2,116,129	44.6%	123,064	5.8 %

Source: management information of the Bank. The data present the principal amount only. Default interest, due and undue interest, commissions, other prepaid expenses and revenue, other restricted revenue and interest and other receivables were not included.

Consumer loans include cash loans and installment loans, overdrafts and credit card debt and the principal amount balance of loans granted to microenterprises, which amounted to PLN 31,890 thousand as at 31 December 2016, as compared to PLN 39,308 thousand as at 31 December 2015. The item does not include mortgaged consumer loans, which were presented in "Mortgaged loans" in the amount of PLN 207.3 million as at 31 December 2016 and PLN 224.2 million as at 31 December 2015.





In 2016 the Bank followed its strategy of focusing on consumer loans and reducing the sale of mortgage loans. The lending activity concentrated on the sale of most profitable products from the point of view of the effect on equity. In 2016 the balance of consumer loans increased by 5.8% and reached 2,239.2 million at the end of December. In 2016 the Bank sold consumer loans with the value of PLN 844.9 million.

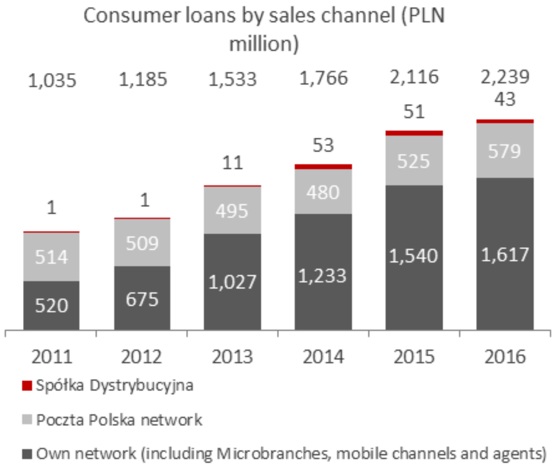
Mortgage loans remain a large portion of the portfolio. As at 31 December 2016, the Bank's receivables due to mortgage loans reached PLN 2,517.3 million and were by 4.1% lower than in December 2015. In 2016 the Bank, offering local currency loans only, extended PLN 69.7 million of mortgage loans, i.e. by 34% less than in 2015, when the sales revenue reached PLN 106.2 million. The decrease resulted from the strategy followed. The Bank focuses

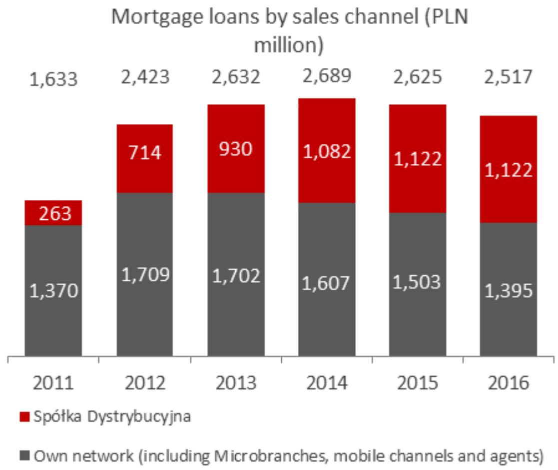
[7] Source: WEBIS data for Bank Pocztowy, data of the National Bank of Poland for monetary receivables and liabilities of financial institutions, December 2016 for the banking sector.

on the sale of products with the highest profitability considering their effect on the capital, which implies promoting the sale of consumer loans.

All mortgage loans are extended by the Bank in the local currency.

Spółka Dystrybucyjna is the only distribution channel for mortgage loans. The key distribution channels for consumer loans are own sales network and the offices of Poczta Polska. The cash loan campaign was supported by BTL[8] marketing activities at the offices of the Bank and Poczta Polska countrywide.





In 2016 the Bank still sold consumer loans to its existing clients under the CRM campaign based on individual limits. Consequently, the share of Bank's clients using loans grew by 2 p.p. (from 10% to 12%) and therefore the yield earned on relationship with these names increased. In 2016 the share of consumer loans sold to existing customers reached 46% as compared to 24% in 2015. The result was generated through:

- more intensive telephone campaigns (by 48%) and texting campaign (by 129%);
- increasing the number of clients who received information about the offer on the phone (by 21%) and by text (by 184%);
- cyclical retention actions addressed to clients with maturing loans;
- using advanced analytics to apply predicting modeling to optimize targeting clients in the campaign;
- optimizing multi-channel process, where the Call Center calls clients from the database and reports sales leads for further processing by the sales network.

BTL (below the line) – highly targeted marketing activities other than advertising in the mass media. BTL marketing media targeted at retailers and consumers are referred to as POP (point of sale) or POP (point of purchase) materials.

3.4. Deposits

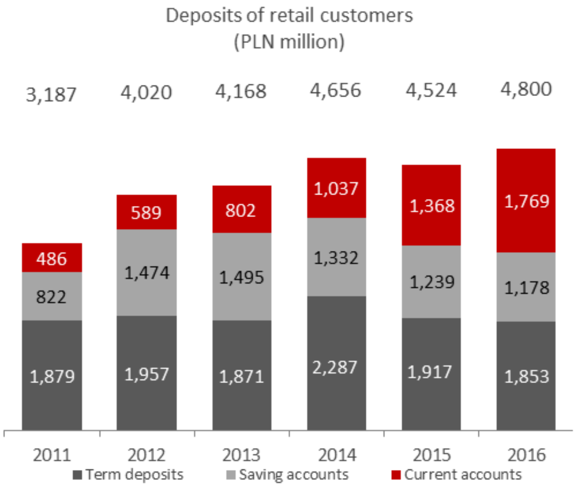
In 2016 the Bank adjusted the speed of developing its deposit base to credit needs, including optimization of the funding costs. At the end of December 2016 individuals deposited in the Bank the total of PLN 4,800.2 million versus PLN 4,523.5 million at the end of December 2015. The balance of deposits in the retail segment grew by PLN 276.7 million.

The growth in deposits of individuals resulted only from the increase in the balance of current accounts. It has grown by PLN 401.0 million, i.e. by 29.3% YoY.

Deposits of Bank Pocztowy S.A. - retail segment (PLN'000)					Change 2016/2015	
	31.12.2016	Structure (31.12.2016)	31.12.2015	Structure (31.12.2015)	PLN '000	%
Customer deposits, including:	4,800,231	100.0%	4,523,510	100.0%	276,721	6.1 %
Current accounts	1,768,796	36.8%	1,367,747	30.2%	401,049	29.3 %
Saving accounts	1,178,656	24.6%	1,238,990	27.4%	(60,334)	(4.9)%
Term deposits	1,852,779	38.6%	1,916,773	42.4%	(63,994)	(3.3)%

Source: management information of the Bank. The data present the principal amount only. Interest accrued and EIR-based fees were not included.

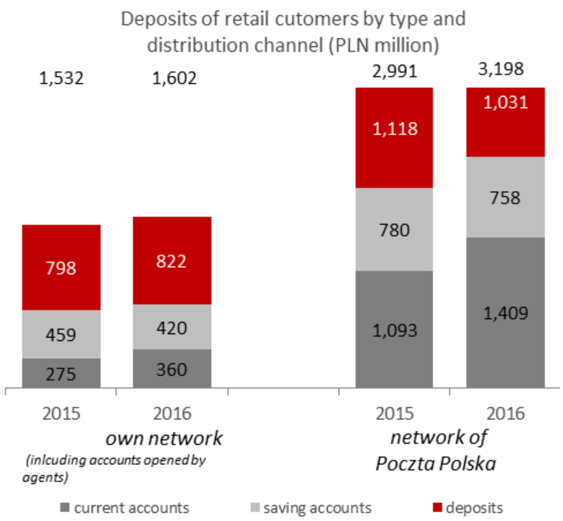
Due to low interest rates the lowest demand was reported for saving accounts and term deposits. In December 2016 retail clients deposited PLN 1,178.7 million on saving accounts at the Bank, i.e. by 60.3 million less than at the end of December 2015. At the end of December 2016 the balance of term deposits amounted to PLN 1,852.8 million and was PLN 64.0 million lower than at the end of 2015. The decrease in the balance of saving accounts and term deposits resulted mainly from the pricing policy adopted by the Bank, which was aimed at reducing the costs of financing and adjusting their level to decreasing interest income, which resulted from low market interest rates.



In 2016 the structure of individual deposits by sales channel did not change considerably comparing to 2015. For many years the offices of Poczta Polska have been the key sales channel for deposit products. At the end of 2016, retail products acquired through the Poczta Polska network accounted for 66.6% of the total balance of deposits, including:

- current accounts – 79.7% (versus 79.9% in December 2015);
- saving accounts – 64.3% (versus 63.0% in December 2015);
- deposits – 55.6% (versus 58.3% in December 2015).

The remaining 33.4% of deposits was acquired through own network of the Bank.



In 2016 the Bank opened 165 thousand new ZawszeDarmowe accounts, including 75% accounts through the network of Poczta Polska. At the end of December 2016 *ZawszeDarmowe* accounts comprised 53% of all accounts of individuals and Pocztowe Konto Nestor accounts - popular in previous years - only 25% of the current account portfolio.

3.5. Investment funds

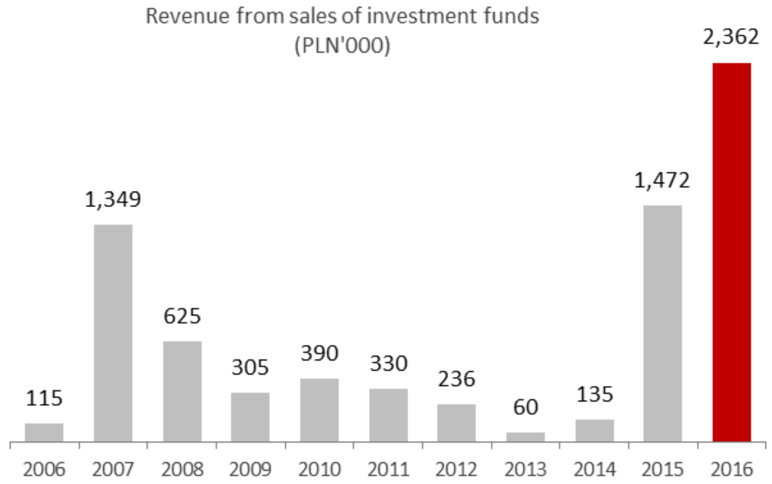
The investment funds' offer constitutes and interesting alternative to the deposit offer for clients with a higher risk appetite.

Since January 2015 the Bank, in cooperation with Ipopema TFI, has offered the possibility to purchase units in selected investment funds (Subfunds: Gotówkowy, Obligacji, Dłużny, Makro Alokacji, Akcji, Globalnych Megatrendów, m-INDEKS, Małych i Średnich Spółek, Short Equity) with a various investment strategy and risk profile. Investment products are available in the Bank's sales network only.

Since 2006 the Bank has offered units of PKO TFI investment funds.

In 2016 the Bank sold investment fund units with the value of PLN 196 million and reported record high revenue from the sale of these units of PLN 2 million.

The best-selling subfund was Ipopema Gotówkowy (Ipopema Cash Fund) with low risk based on secure highly liquid assets (debt instruments and cash) with a minimum 6-month investment period.



In 2016 the Bank's clients developed their investment competencies, which translated into a growth in the share of higher risk subfunds, such as Ipopema Dłużny (Ipopema Debt Fund), Pocztowy Stabilny (Postal Bank Stable Fund) and Ipopema Obligacji (Ipopema Bond Fund). The decrease in the balance of some high-risk funds, such as Ipopema Akcji (Ipopema Equity Fund), Ipopema Makro Alokacji (Ipopema Makro Equity Fund) and Ipopema MiŚS (Ipopema SME Fund) resulted from disadvantageous situation in the market and replacing these funds in the "Lokata z Funduszem" product with Bank "Pocztowy SFIO" subfunds, in particular "Stabilny" (Stable) subfund.

3.6. Bank cards

In 2016 Bank Pocztowy offered the following types of bank cards to consumers:

- MasterCard and Visa Electron debit cards issued to personal accounts;
- Visa Business Elektron cards issued to Pocztowe Konto Firmowe accounts;
- MasterCard and Visa Classic credit cards.

Debit and credit cards held by retail customers ('000)

	2011	2012	2013	2014	2015	2016	Change 2016/2015 '000	%
Cards, including:	**130**	**150**	**204**	**241**	**257**	**276**	**19**	**7.4 %**
MasterCard and Visa Electron	121	132	183	221	239	259	20	8.3 %
Visa Business Electron	4	4	5	6	7	7	0	0.4 %
MasterCard and Visa Classic credit cards	5	13	15	13	10	9	(1)	(9.6)%
Prepaid			1	1	0	0	0	-

At the end of 2016 the payment card portfolio for consumers amounted to PLN 276 thousand, out of which 97% were debit cards.

Major changes in the payment card offer of the Bank:

- new prices for issuing cards and processing card transactions were introduced in February 2016;
- the strategy aimed at increasing the number of transactions made by consumers using their first debit cards was launched on 1 June 2016;
- the sales support program Bank Pocztowy Card Ambassadors for own sales network, aimed at increasing commitment of Relationship Managers selling cards, developing their knowledge and exchanging best practices in card selling was implemented on 1 July 2016;
- the possibility to accept transfers by individuals using payment cards and MasterCard Money Send or Visa Personal Payments services was introduced on 1 July 2016;
- a promotional program "Card benefits at a post office" supporting installation of payment terminals at post offices. The program was targeted at the Bank's retail customers, who received a cash bonus of 10% of the debit card transaction related to the purchase of goods or services (at maximum PLN 10 per person per month) made at a post office, which was credited to a card account;
- At the same time, the Bank launched promotion of Cash Back services (cash withdrawal at payment) at post offices and outlets earmarked 'Visa CashBack' or 'MasterCard: Pay card and withdraw cash'. The maximum amount of a single payment using MasterCard has been increased to PLN 500.

Translation 10% bonus on payment card at the post office

On 1 December 2016 the Bank, in cooperation with Euronet, introduced proximity transaction services for cash withdrawals.

4. Activities in the institutional market

4.1. Institutional banking clients

Applying general, financial and business relations criteria, the Bank has divided its institutional clients into the following categories:

- small and medium enterprises (SME);
- housing institutions such as condominiums, housing associations, property managers and social housing associations;
- Public Finance and Public Benefit Organizations to include associations, labor unions and other organizations;
- Poczta Polska and companies from its Capital Group.

14.9
thousand institutional clients
As at 31.12.2016

At the end of 2016 Bank Pocztowy had the total of 14.9 thousand institutional clients. The housing segment (11.2 thousand clients) is the largest group of institutional clients.
The institutional segment does not include microenterprises, which are included into the retail segment in management reporting of the Bank.

4.2. Development of the product offer for institutional clients

The key product in packages tailored to individual needs of institutional client segments is the current account. The Bank offers the following types of current accounts to institutional clients:

- Pocztowy Biznes Pakiet (Business Postal Package) – targeted at all SMEs, real property managers and administrators, Public Finance sector, public benefit organizations, NGOs, Poczta Polska S.A. and companies from the Poczta Polska Capital Group;
- Pocztowy Pakiet MINI DOM (Mini House Postal Package) – targeted at condominiums which enter into a limited number of transactions, generate low revenue and use a narrow range of bank products; The package is offered at lower price, but additional fees and charges for individual services;
- Pocztowy Pakiet DOM (House Postal Package) – full offer for condominiums. A higher product price is offered in the package, but transfers are made free of charge.

As a part of the settlement products development strategy, a new service "Giro Wysyłka" (Giro Transfer) was launched. The service enables transferring cash from Bank offices to over 200 countries.

The Bank offers the following deposit products:

- standard fixed-rate deposits with the tenor of 3, 6 and 12 months and the minimal amount of PLN 1 thousand;
- individually negotiated deposits for at least PLN 50 thousand;
- automatically renewed overnight deposits of at least PLN 50 thousand with more advantageous interest rates than those proposed for overdrafts;
- Konto Oszczędnościowe Biznes (Business Saving Accounts) - for all segments; The account interest rate depends on the account balance;
- bank accounts in foreign currencies (USD, EUR, GBP, CHF, CAD).

The Bank offers comprehensive settlement services based on the access to Poczta Polska's infrastructure. The services include: managing cash payments made in other banks and handling payments made to the Social Insurance Institution and Tax Offices.
The Bank's settlement offer includes:

- Giro Płatność (Giro Payment) (cash payments to third parties available at the offices Poczta Polska and the Bank's own network),
- Giro Wysyłka (Giro Transfer) (making cash transfers from the Bank's own network),
- over-the-counter deposits (cash payments to the client's account at the offices of Poczta Polska and the Bank's own network based on standard or individual terms),
- Pocztowy Collect (identifying bulk payments using virtual accounts generated to a client's bank account),
- Pocztowy Przelew Zbiorczy (Postal Collective Transfer) (managing bulk domestic non-cash payment orders in the Polish zloty),
- sealed cash deposits (accepting sealed cash deposits from clients).

Further, in 2016 the Bank continued relationships with companies offering international cash transfers. The Bank's key competitive advantage is the widest distribution network in Poland, composed of post offices and bank's sales points where customers can collect cash transfers.

The Bank's credit offer for institutional clients includes in particular:

- revolving loans;
- non-revolving working capital loans;
- investment loans;
- loans with thermal improvement and refurbishment premium;
- loans for refurbishment and construction purposes;
- mortgage loans;
- bank guarantees.

The treasury offer for institutional clients includes:

- currency forward contracts,
- purchase and sale of debt securities (treasury and non-treasury securities, certificates of deposit),
- possibility to conclude currency forward transactions under a treasury limit.

In order to improve competitiveness of its offer for institutional clients the following steps have been taken by the Bank:

- launching a new service for making cash transfers from the Bank's own network);
- starting works on offering cash transfers in the Poczta Polska network;
- adjusting the deposit offer to market terms.

4.3. Credit operations

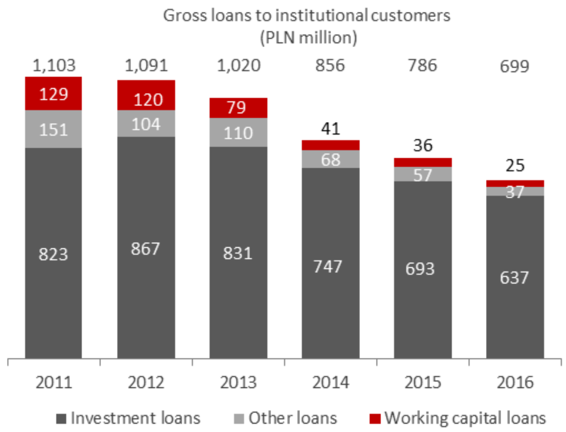
As at 31 December 2016 the Bank's credit receivables from institutional clients totaled PLN 699.2 million and were by PLN 11,0% lower than in December 2015.

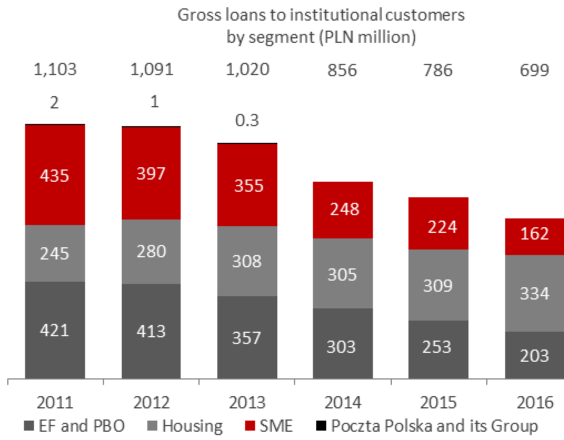
Loans originated in the institutional segment by Bank Pocztowy S.A. (PLN'000)						
	31.12.2016	Structure (31.12.2016)	31.12.2015	Structure (31.12.2015)	Change 2016/2015 PLN '000	%
Loans granted to institutions	**699,182**	**100.0%**	**785,612**	**100.0%**	**(86,430)**	**(11.0)%**
Investment loans	636,910	91.1%	692,500	88.2%	(55,590)	(8.0)%
Working capital loans	25,049	3.6%	35,637	4.5%	(10,588)	(29.7)%
Other loans	37,223	5.3%	57,475	7.3%	(20,252)	(35.2)%

Source: management information of the Bank. The data present the principal amount only. Default interest, due and undue interest, EIR fees, other prepaid expenses and accrued income, other restricted revenue and interest were not included.

Lower balances of loans granted to institutional clients reported in 2016 resulted from a strategic decision of the Bank to change the credit policy in this respect and reduce financing extended to these client groups. In 2016, like in 2015, the Bank limited its new loans and facilities were granted mainly to its key clients, mainly from the Housing segment (condominiums, housing associations, property managers and social housing associations), holding considerable deposits and using settlement services. The credit policy related to institutional clients was changed to increase the yield on new loans and ensure capital sufficient to grow new loans in the retail segment.

Investment loans had the highest share in the institutional clients portfolio. At the end of 2016 investment loans accounted for 91.1% of the total credit receivables of the Bank due from this customer group.





4.4. Deposits

As at 31 December 2016 deposits of institutional clients amounted to PLN 949.7 million, i.e. by PLN 106.8 million less than at the end of 2015. The decrease in liabilities to this client category resulted from adjusting the level of deposits to liquidity needs of the Bank and limited lending activity, in particular to SMEs.

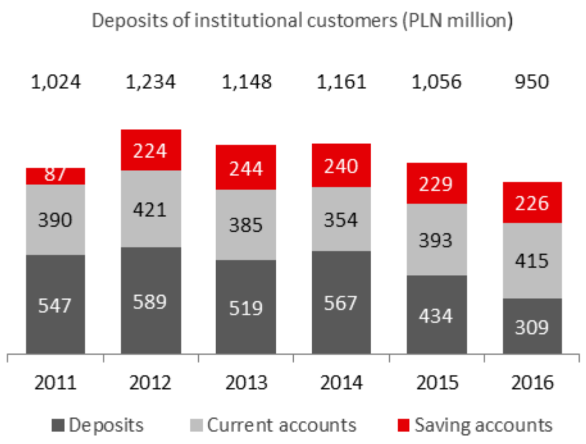
Deposits of the institutional segment in Bank Pocztowy S.A. (PLN'000)						
	31.12.2016	Structure (31.12.2016)	31.12.2015	Structure (31.12.2015)	Change 2016/2015 PLN '000	%
Total institutional deposits	**949,653**	**100.0%**	**1,056,431**	**100.0%**	**(106,778)**	**(10.1)%**
Current accounts	414,860	43.7%	392,984	37.2%	21,876	5.6 %
Saving accounts	226,063	23.8%	228,996	21.7%	(2,933)	(1.3)%
Deposits	308,730	32.5%	434,451	41.1%	(125,721)	(28.9)%

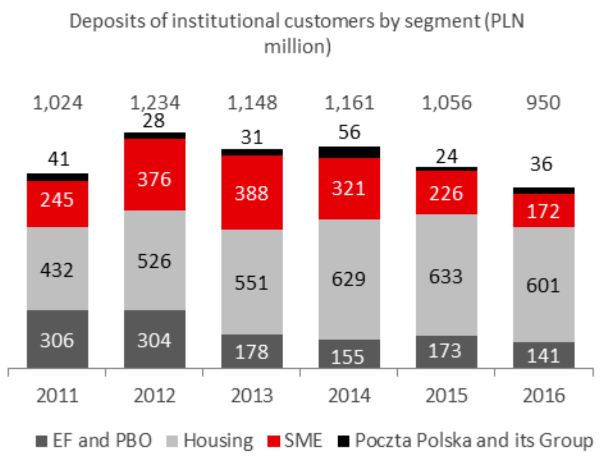
Source: management information of the Bank. The data present the principal amount only. Interest accrued and EIR-based fees were not included. Deposits without individually negotiated deposits of Poczta Polska.

At the end of December 2016, the balance of cash on current accounts of institutional clients increased to PLN 414.9 million, i.e. it was by 5.6% higher than on 31 December 2015. At the end of 2016 Bank Pocztowy managed 20,3 thousand active current accounts of institutional clients, i.e. the number of accounts had not changed much since December 2015.

In 2016 the Bank was less active in acquiring individually negotiated deposits with high interest rates, because the portfolio of highly stable deposits of individuals had been growing. Consequently, the balance of term deposits amounted to PLN 308.7 million and was by PLN 125.7 million lower than at the end of December 2015.

At the end of 2016 the total balance deposited on saving accounts decreased by PLN 2.9 million to PLN 226.1 million.





Housing institutions where those to deposit the highest amount at the Bank. In December 2016 the value of deposits in the housing segment reached PLN 600.5 million and constituted 63.2% of the total deposits of institutional clients. Deposits of SMEs were also considerable and amounted to PLN 172.4 million, i.e. accounted for 18.1% of the total deposits of institutional clients.

5. Treasury operations

Treasury operations of Bank Pocztowy focus on:

- managing the market interest rate exposure and short-term exposure under the Banking Book and managing currency risk exposure under the Trading Book;
- trading operations on own account and transaction with the Bank's clients;
- managing long-term liquidity risk through the issue of long-term debt securities of the Bank.

5.1. Banking book

1,465
(PLN million)
investment financial assets

As at 31.12.2016

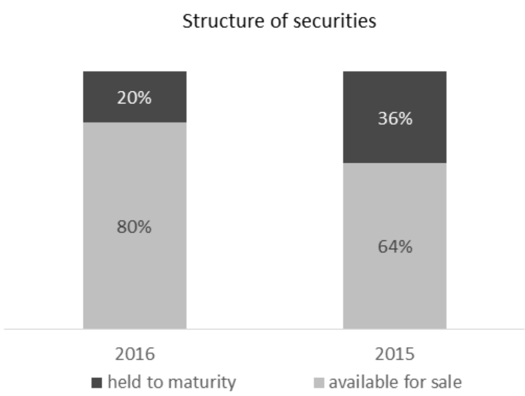
In 2016 the Bank concluded mainly sale and purchase transactions in securities, *sell-buy-back* and *buy-sell-back* transactions and deposited or borrowed funds in the interbank market as a part of managing short-term liquidity and interest rate risk. Moreover, it entered into derivative transactions such as FRA or IRS to hedge against interest rate risk.

At the end of 2016 the total investments in financial assets of the Bank reached PLN 1,464.6 million, i.e. by PLN 216.5 million (17.3%) more than at the end of 2015. The change resulted mainly from a higher balance of Government Bonds, which amounted to PLN 1,358.6 million at the end of December 2016 and was by PLN 184.3 million (i.e. 15.7%) higher than at the end of 2015. Government Bonds accounted for 92.8% of financial assets in the entire investment portfolio.

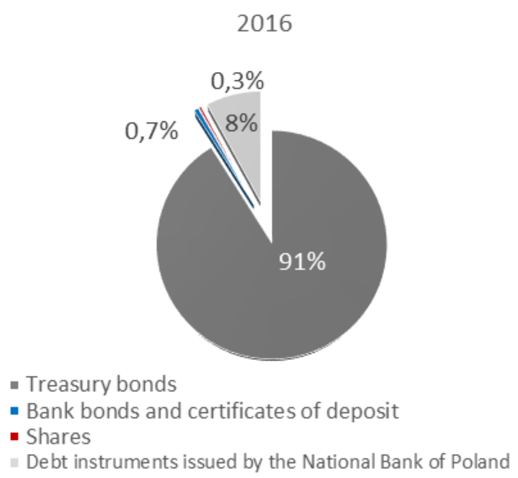
Investments in financial assets (PLN '000)	31.12.2016	31.12.2015	Change 2016/2015 PLN '000	%
Investments in financial assets	**1,464,557**	**1,248,037**	**216,520**	**17.3 %**
available for sale, including:	**1,175,686**	**803,347**	**372,339**	**46.3 %**
Treasury bonds	1,069,691	779,609	290,082	37.2 %
Bank bonds and certificates of deposit	8,988	8,924	64	0.7 %
Shares	4,019	14,814	(10,795)	(72.9)%
Debt instruments issued by the National Bank of Poland	92,988	-	92,988	-
held to maturity, including:	**288,871**	**444,690**	**(155,819)**	**(35.0)%**
Treasury bonds	288,871	394,645	(105,774)	(26.8)%
Bank bonds and certificates of deposit	-	50,045	(50,045)	(100.0)%

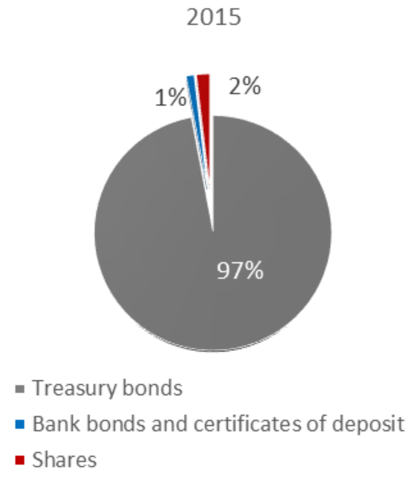
Investment financial assets available for sale with the total value of PLN 1,175.7 million accounted for 80.3% of investment financial assets, and the remaining 19.7% were bonds held to maturity, the value of which was PLN 288.9 million.

In its securities portfolio the Bank also holds debt securities issued by other banks, classified to loans and receivables and presented as receivables from other banks. As at 31 December 2016 the balance of securities was PLN 40.2 million and was similar to that reported a year before.

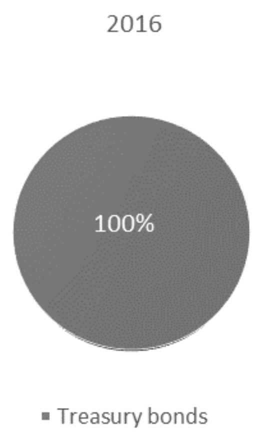


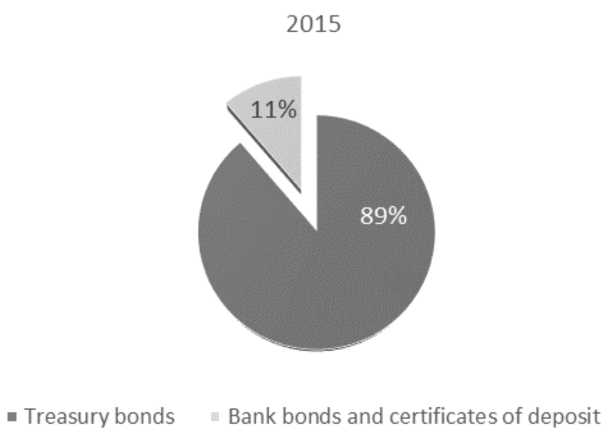
Structure of securities available for sale





Structure of securities held to maturity



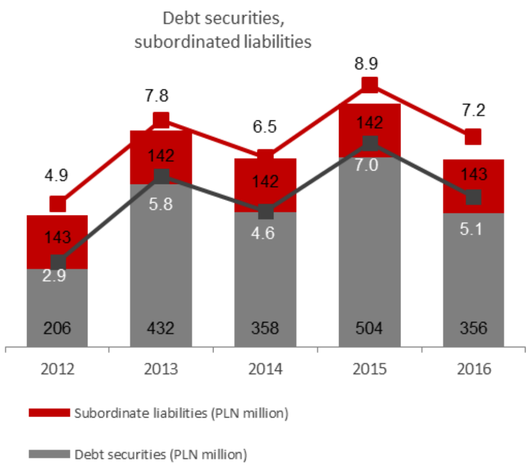


In 2016 interest income on investment financial assets and receivables from other banks amounted to PLN 35.4 million and was by 11.4% lower than in 2015. The decrease resulted from low market interest rates.

To diversify the sources of funding and provide additional sources of long-term financing the Bank issued long-term debt securities.

The total debt securities and subordinated liabilities amounted to PLN 498.5 million, which accounted for 7.2% of the balance sheet total of the Group.

As at 31 December 2016 liabilities due to issue of debt securities (excluding subordinated liabilities) accounted for 5.1% of the total liabilities and equity of the Bank, as compared to 7.0% at the end of December 2015. Their share dropped by 1.9 p.p. when the Bank had redeemed ordinary B2 series bearer bonds with the face value of PLN 147.9 million. The B2 series bonds were traded in the Catalyst alternative trading system of the Warsaw Stock Exchange (Catalyst).



The Bank holds subordinated liabilities, which amounted to PLN 142.8 million at the end of December 2016. Subordinated bonds worth PLN 99.7 million (as at 31 December 2016), traded in the Catalyst alternative trading system of the Warsaw Stock Exchange are the largest item in subordinated loans.

The following changes occurred in subordinated liabilities in 2016:

- The Bank redeemed 4,734 subordinated bearer bonds with the total face value of 47.3 million before their maturity.
- It had issued securities with the total face value of PLN 50 million.

As at 31 December 2016 subordinated liabilities of the Group also included a loan from Poczta Polska of PLN 43.1 million.

In 2016 the Bank followed hedge accounting principles concerning future cash flows in floating rate portfolios denominated in PLN. Hedging relationships are developed using Interest Rate Swaps. As at 31 December 2016 the face value of hedged items amounted to PLN 215 million and increased by PLN 75 million since 31 December 2015.

5.2. Trading book

At the end of December 2016 the Bank entered into transactions in 10 foreign currencies: EUR, USD, GBP, CHF, JPY, CAD, CZK, SEK, DKK and NOK.

In 2016 the Bank also traded in interest rate financial instruments, but the activities were quite limited.

In 2016 the Bank's trade transactions in the currency and interest rate market (trading in treasury bonds) remained insignificant.

6. Activities of companies from the Bank's Capital Group

6.1. Bank Pocztowy Capital Group

No changes in the structure of the Bank Pocztowy Capital Group took place in 2016. Holding 100% of shares in each subsidiary, the Bank carries out its supervisory function through its representatives working and exerting control in supervisory boards of the companies. Operations of the subsidiaries considerably support business operations of the parent.

Companies from the Capital Group hold current accounts and deposit free cash using term deposits in Bank Pocztowy. Related-party transactions are carried out at arm's length.

6.2. Centrum Operacyjne Sp. z o.o.

Centrum Operacyjne was established by the Bank on 20 May 2010 with the share capital of PLN 2 500 thousand. All shares were assumed by Bank Pocztowy. On 1 July 2010 the Shareholders' Meeting increased the share capital by PLN 783.8 thousand up to PLN 3,283.8 thousand.

The core business of Centrum Operacyjne includes supporting settlement processes of Bank Pocztowy, clients of the Bank Pocztowy Capital Group and Poczta Polska. It carries out its tasks using competencies and experience gained at the Bank. The company manages business processes using specialized tools, which enables it to tailor its approach to support and manage operating processes. For process optimization, Centrum Operacyjne uses modern lean management tools. The processes managed are constantly improved through elimination of bottlenecks. Additionally, the company has implemented the "paperless office" initiative.

As at 31 December 2016, the balance sheet total of Centrum Operacyjne amounted to PLN 4,664.0 thousand. In 2016 the company reported a net profit of PLN 81.4 thousand, as compared to PLN 181.4 thousand reported in 2015.

6.3. Spółka Dystrybucyjna Banku Pocztowego Sp. z o.o

Spółka Dystrybucyjna was established by the Bank on 20 May 2010 with the share capital of PLN 2,000 thousand. All shares were assumed by Bank Pocztowy. On 30 September 2011, the Extraordinary Shareholders' Meeting increased the share capital of the company by PLN 679.8 thousand up to PLN 2,679.8 thousand.

The core business of the company includes the sale of financial products and services, aimed, in particular, at diversifying product and service distribution channels of the Bank and supporting its sales channels. The company's objective is also to attract new clients not using the Bank's services, e.g. due to a considerable distance from the nearest office.

At the end of 2016 Spółka Dystrybucyjna cooperated with 92 Mobile Relationship Managers, while a year before the Bank's products had been distributed by 93 RMs.

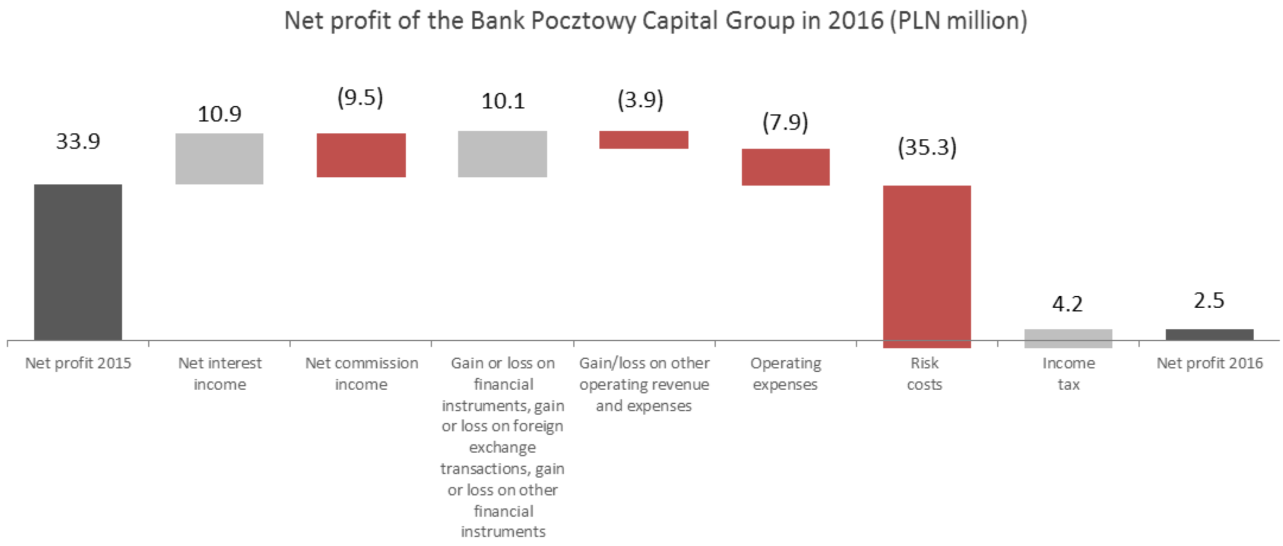
As at 31 December 2016, the balance sheet total of Spółka Dystrybucyjna amounted to PLN 3,177.0 thousand. In 2016 Spółka Dystrybucyjna incurred a net loss of PLN 101.7 thousand, due to a decrease in the fee income of PLN 1.8 million. In 2015, however, the company generated a net profit of PLN 118.4 thousand.

7. Financial performance of the Group

7.1. Key factors determining the Group's financial profit or loss

In 2016 the Group generated a gross profit of PLN 7.3 million versus PLN 42.9 million in 2015. The net profit amounted to PLN 2.5 million, as compared to 33.9 million a year before.

The key changes in income statement items:



The financial performance of the Group in 2016 was adversely affected by the following one-off events:

- recognition in the net fee income and other operating expenses of additional provisions in the amount of PLN 6.2 million and PLN 3.9 million, respectively, for potential claims resulting from pending proceedings instigated on 4 December 2015 by the President of the Office for Competition and Consumer Protection with respect to inappropriate method of informing clients of changes in the Regulations and the Fees and Commissions and additional charges introduced by the Group and relating to bank statements distributed by the Group for the period from July to December 2015 and in 2016;
- writing off IPO expenses incurred in 2015 and 2016 of PLN 3.2 million and charging them to other operating expenses;
- recognition of a provision for termination benefits under non-competition agreements with Members of the Management Board of the Bank of the 9th term of office of PLN 2.4 million;
- payment to the Bank Guarantee Fund under Resolution of BFG Management Board no. 308/DGD/2016 of 28 October 2016 in the amount of PLN 0.8 million for payment of guaranteed funds to depositors of Bank Spółdzielczy in Nadarzyn.

The total impact of non-recurring events in 2016 was PLN 16.5 million.

The key item adversely affecting financial performance of the Group in 2016 was higher impairment losses on loans and advances, which grew by PLN 35.3 million during the year and reached PLN 100.5 million in 2016. This item increased significantly because additional impairment losses were recognized for the portfolio of cash loans and installment loans for years 2013-2016. In case of this group of loans, which is highly promoted by the Bank, a 80% growth in impairment losses amounted to PLN 42.9 million. The credit policy, pricing policy and management decisions made in the past did not sufficiently hedge the Group's credit risk.

On the other hand, the event which positively affected the financial performance of the Group was the settlement of the sale of shares in VISA Europe Limited. The Group generated related revenue of PLN 16.9 million.

Moreover, apart from one-off events, which considerably increased the expenses, the profit of the Group was affected by the following factors:

- The increase in the net interest income, despite record low interest rates. In 2016 the net interest income amounted to PLN 267.7 million, i.e. was by 4.2% higher than the same time last year. The increase resulted mainly from adjusting the deposit offer to the market situation and the increase in the sales volume of consumer loans.
- Apart from the aforementioned provision of PLN 6.2 million, the decrease in the net fee and commission income of PLN 9.5 million resulted from a lower number of bank accounts on which maintenance fees are charged, stemming from a decrease in the number of accounts maintained by the Group and conversion of bank accounts to *ZawszeDarmowe* accounts which are maintained free of charge.
- A gain on other revenue and operating expenses lower by PLN 3.9 million. The decrease resulted from the adverse non-recurring events discussed above which increased other operating expenses.
- A growth in administrative expenses of PLN 7.9 million, which resulted mainly from the increase in personnel expenses stemming from the growth of base pay of sales network employees (a new career path introduced in the second quarter of 2015) and recognition of provisions for costs of non-competition agreements with Members of the Management Board of the 9th term of office. Non-personnel expenses were additionally increased by the tax on certain financial institutions introduced in February 2016, which amounted to PLN 4.8 million in 2016.

Significantly, in line with the Group's estimates, the net profit of the Group, adjusted by the impact of the increase in impairment losses on loans and advances and negative one-off events would amount to PLN 40 million.

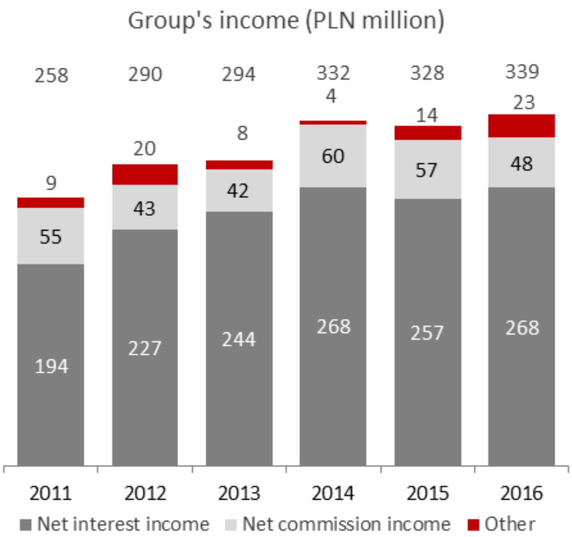
The key income statement items:

Key items the income statement of the Bank Pocztowy S.A. Capital Group (PLN'000)				
	2016	2015	Change 2016/2015 PLN '000	%
Operating income	**339,081**	**327,528**	**11,553**	**3.5 %**
Net interest income	267,696	256,822	10,874	4.2 %
Net fee and commission income	47,727	57,190	(9,463)	(16.5)%
Dividend income	18	-	18	-
Gain or loss on financial instruments measured at fair value through profit or loss and gain or loss on foreign exchange transactions	3,395	1,789	1,606	89.8 %
Gain or loss on other financial instruments	20,245	11,727	8,518	72.6 %
Gain/loss on other operating revenue and expenses	**(6,375)**	**(2,461)**	**(3,914)**	**159.0 %**
General and administrative expenses	**(224,898)**	**(217,030)**	**(7,868)**	**3.6 %**
Net impairment losses	**(100,496)**	**(65,158)**	**(35,338)**	**54.2 %**
Operating profit/loss	**7,312**	**42,879**	**(35,567)**	**(82.9)%**
Gross financial profit/loss for the current period	**7,312**	**42,879**	**(35,567)**	**(82.9)%**
Income tax	(4,802)	(8,948)	4,146	(46.3)%
Net financial profit/loss for the current period	**2,510**	**33,931**	**(31,421)**	**(92.6)%**

Net interest income

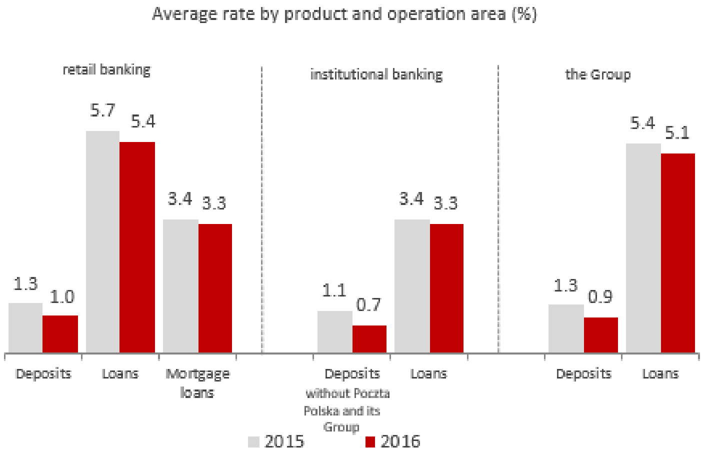
In 2016, the net interest income constituted the key source of income for the Group. It reached PLN 267.7 million and was by PLN 10.9 million, i.e. 4.2% higher than in 2015.

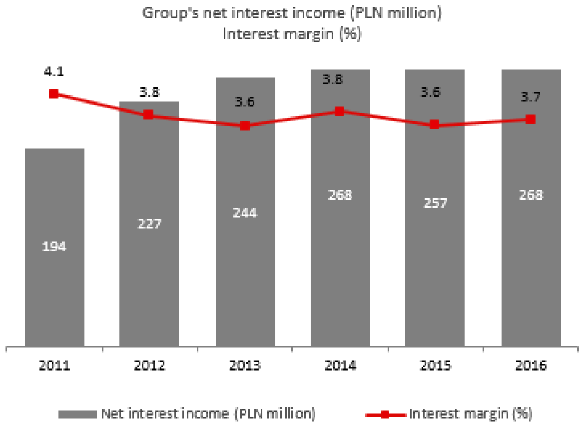
In 2016 the net interest income increased, while the interest income and interest expense of the Group decreased, i.e.:



- Interest income, which in 2016 amounted to PLN 348.6 million were by PLN 5.2 million, i.e. 1.5% lower than in 2015. The decrease resulted mainly from lower income on investment financial assets held to maturity, which, in turn, resulted from a decrease in the portfolio value which was reported when the Group no longer purchased new debt securities qualified to the portfolio. This item amounted to PLN 9.5 million and was by 41.9% lower than in 2015. The interest income on loans and term loans granted to institutional clients and local government institutions also decreased by 17.9% and 19.1%, respectively, when the balance of loans decreased because the Group had followed the policy of reducing lending to these clients. Additionally, interest income on overdrafts dropped by 28.7%, because the overdraft volume had decreased.
- In 2016 interest expense amounted to PLN 81.0 million and was by PLN 16.1 million, i.e. 16.6% lower than in 2015. In 2016 the Bank adjusted its pricing policy concerning deposits to lower market interest rates, therefore the Group incurred much lower interest expense due to term deposits of all groups of clients.

Interest income and interest expense of the Bank Pocztowy S.A. Capital Group (PLN'000)				
	2016	2015	Change 2016/2015 PLN '000	%
Interest income	**348,647**	**353,887**	**(5,240)**	**(1.5)%**
Income on receivables from banks	**4,773**	**4,914**	**(141)**	**(2.9)%**
Income on loans and advances to customers, including:	**313,217**	**313,812**	**(595)**	**(0.2)%**
Overdraft facilities	2,999	4,209	(1,210)	(28.7)%
Credit facilities and term loans	310,218	309,603	615	0.2 %
individuals	282,625	275,875	6,750	2.4 %
institutional customers	21,779	26,540	(4,761)	(17.9)%
local government	5,814	7,188	(1,374)	(19.1)%
Income on investments in financial assets classified as:	**30,657**	**35,089**	**(4,432)**	**(12.6)%**
available for sale	21,159	18,729	2,430	13.0 %
held to maturity	9,498	16,360	(6,862)	(41.9)%
Income on financial assets held for trading	**0**	**72**	**(72)**	**(100.0)%**
Interest expense	**(80,951)**	**(97,065)**	**16,114**	**(16.6)%**
Expense due to liabilities to other banks	**(56)**	**(1,125)**	**1,069**	**(95.0)%**
Expense due to liabilities to customers, including:	**(54,923)**	**(73,287)**	**18,364**	**(25.1)%**
Current accounts	(10,490)	(16,975)	6,485	(38.2)%
Term deposits	(44,433)	(56,312)	11,879	(21.1)%
individuals	(37,457)	(46,370)	8,913	(19.2)%
institutional customers	(6,683)	(9,489)	2,806	(29.6)%
local government	(293)	(453)	160	(35.3)%
Costs due to highly liquid and subordinate bonds and subordinate loan	(24,562)	(20,384)	(4,178)	20.5 %
Costs arising from repo and sell-buy-back securities	(1,246)	(2,141)	895	(41.8)%
Costs related to hedging instruments	(164)	(128)	(36)	28.1 %





Interest margin is accounted as the relation of net interest income for specified period and the level of average assets (accounted as the average from daily values)

As a result of a higher net interest income in 2016 the Group reported a 0.1 p.p. increase in the net interest margin versus 2015. In 2016 the net interest margin amounted to 3.7%, i.e. much more than the average margin in the banking sector (2.3%).[9]

Net fee and commission income

Net fee and commission income was the key element of non-interest income of the Group. It amounted to PLN 47.7 million and was by 16.5% lower than in the previous year.

Fee and commission income and expense of the Bank Pocztowy S.A. Capital Group (PLN'000)

	2016	2015	Change 2016/2015 PLN '000	%
Fee and commission income	**93,109**	**101,063**	**(7,954)**	**(7.9)%**
settlement and cash transactions	45,637	45,401	236	0.5 %
keeping bank accounts	16,316	25,221	(8,905)	(35.3)%
payment and credit cards	19,978	19,520	458	2.3 %
sale of insurance products	3,371	3,412	(41)	(1.2)%
investment fund services	2,445	1,667	778	46.7 %
originated loans and advances	874	1,097	(223)	(20.3)%
other	4,488	4,745	(257)	(5.4)%
Fee and commission expense	**(45,382)**	**(43,873)**	**(1,509)**	**3.4 %**
keeping current accounts and term deposits	(17,718)	(18,071)	353	(2.0)%
cash card services, payments made in ATM and POS	(14,541)	(12,853)	(1,688)	13.1 %
cash and settlement services provided to Group entities	(8,110)	(7,916)	(194)	2.5 %
other services	(5,013)	(5,033)	20	(0.4)%

Commission income amounted to PLN 93.1 million and was by 7.9% lower than in 2015.

The Group reported lower income from bank account maintenance (by 35,3%). The decrease resulted from:

- recognition of additional provisions in the amount of PLN 6.2 million for potential claims resulting from pending proceedings instigated on 4 December 2015 by the President of the Office for Competition and Consumer Protection with respect to inappropriate method of informing clients of changes in the Regulations and the Fees and Commissions and additional charges introduced by the Bank and relating to bank statements for 2016;
- a decrease in the number of bank accounts on which maintenance fees are charged stemming from a decrease in the number of accounts maintained by the Group and conversion of bank accounts to

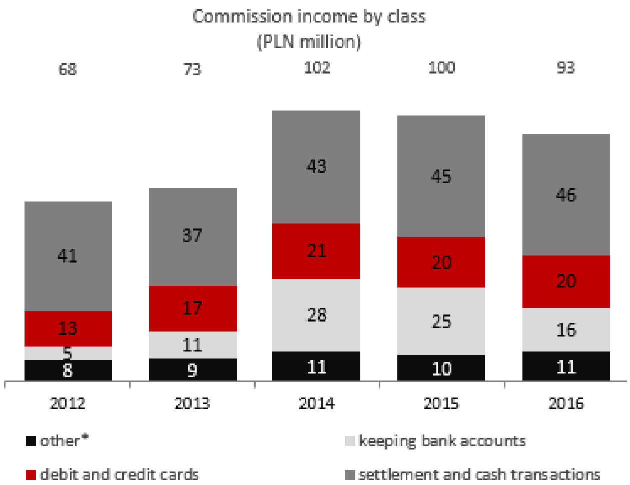
[9] Source: Financial Supervision Authority, monthly data for the banking sector file – December 2016.

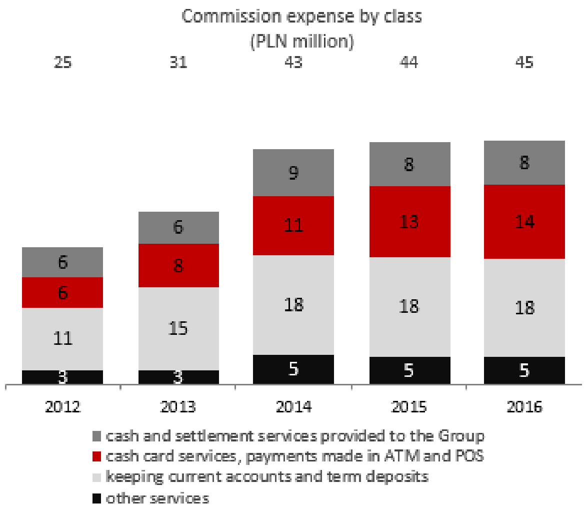
ZawszeDarmowe accounts which are maintained free of charge.

At the same time, the Group increased the sale of investment fund units and made the offer more attractive, hence the Group increased the revenue from sale of investment funds by 46.7%. The revenue from payment cards and credit cards increased as result of a higher number of ATM cash withdrawals.

In 2016 the fee and commission expense increased as well up to PLN 45.4 million, being 3.4% higher than in 2015. The Group saw an increase in the fee and commission expenses resulting from:

- an increase in the number of card transactions made by clients as a result of the growing popularity of card transactions resulting from the widespread contactless payments for small amounts and the development of the network of readers and terminals. The number of non-cash transactions made using debit cards grew by 72.8% and the number of proximity card transactions by 56.7%. The costs of payment card services, payments made in ATMs and POSs were by 1.7 million, i.e. 13.1% higher than in 2015.





*Other commission income included: income from sale of insurance products, investment funds management, originated loans and advances, and other income. In 2010 and 2011 the consolidated financial statements did not account for adjustment of bancassurance income. The Group decided to not disclose these items for data comparability reasons.

Other income

In 2016 the gain on financial instruments measured at fair value through profit or loss, gain on foreign exchange transactions and gain on other financial instruments amounted to PLN 23.6 million versus PLN 13.5 million reported in 2015.

In 2016 the Group reported a net investment income of PLN 20.2 million, i.e. by PLN 8.5 million higher than the same time last year. The improvement resulted from income from the sale of shares in VISA Europe Limited ("VISA Europe"). On 21 June 2016, the transaction involving acquisition of Visa Europe by Visa Inc. was concluded. Following its settlement including amendments to original transaction terms, the Bank has received the following consideration for its share in Visa Europe:

- EUR 2,787 thousand in cash;
- 1,011 preference C series shares convertible to ordinary A series shares in Visa Inc.;
- a share in deferred payment of 0.0214748639% of the amount earmarked for this purpose (EUR 1.12 billion) subject to a provision that the amount may be adjusted. The deferred payment will be receivable three years of the transaction closing. Therefore, when recognizing this portion of the consideration, the Bank has applied a 2% discount to be brought forward until the date of receiving the related funds.

The total consideration arising from acquisition of Visa Europe by Visa Inc., recognized in consolidated income statement of the Group amounted to PLN 16,872 thousand and included:

- PLN 12,244 thousand in cash;
- PLN 3,592 thousand of income from preference C series shares convertible to ordinary A series shares in Visa Inc.;
- PLN 1,036 thousand of income from the Group's share in the deferred cash payment.

At the end of 2016 the gain on financial instruments measured at fair value through profit or loss and a gain on foreign exchange transactions amounted to PLN 3.4 million versus PLN 1.8 million reported in 2015. The highest increase was reported in derivative transactions. The gain on foreign exchange transactions amounted to PLN 3.1 million and was by PLN 0.6 million higher than in 2015.

In 2016 other operating income (other revenue/operating expenses) amounted to PLN (6.4) million as compared to PLN (2.5) million at the end of 2015. Other operating income amounted to PLN 3.6 million and was by PLN 1.1 million lower than in 2015, mainly as a result of lower income from reimbursement of costs of collections (under proceedings before court and amounts collected by debt collectors).

In 2016 other operating expense amounted to PLN 10.0 million and was PLN 2.8 million higher than in 2015. As discussed above, the costs of additional provisions for possible future liabilities arising from the pending proceedings instigated by the President of the Office for Competition and Consumer Protection and the costs of writing off receivables (IPO expenses of PLN 3.2 million) increased.
At the same time, the Group reported a decrease in costs of damages and fines (by PLN 1.8 million) which was related to the fine paid in 2015 when the decision of the President of the Office for Competition and Consumer Protection No. DAR 15/2006 on fining banks for joint determination of the "interchange" rate entered info force.

General and administrative expenses

In 2016, the bank's general and administrative expenses amounted to PLN 224.9 million and were by 3.6% higher comparing to 2015.

Administrative expenses and amortization/depreciation of the Bank Pocztowy S.A. Capital Group (PLN'000)

	2016	Structure (2016)	2015	Structure (2015)	Change 2016/2015 PLN '000	%
Administrative expenses including amortization/depreciation	**(224,898)**	**100.0%**	**(217,030)**	**100.0%**	**(7,868)**	**3.6 %**
Employee benefits	(102,105)	45.4%	(95,276)	43.9%	(6,829)	7.2 %
Non-personnel costs	(98,909)	44.0%	(103,576)	47.7%	4,667	(4.5)%
Amortization/depreciation	(23,884)	10.6%	(18,178)	8.4%	(5,706)	31.4 %

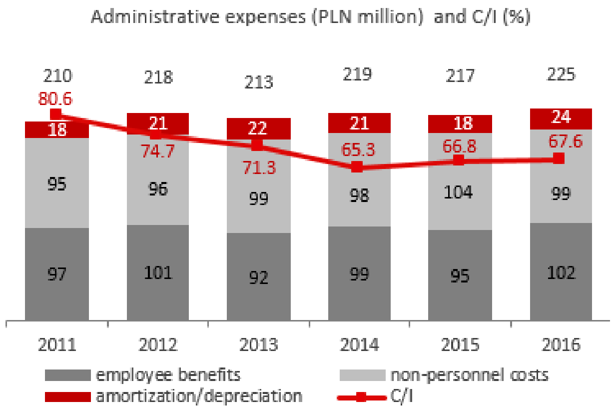
Employee benefits constituted the key cost item in 2016. In 2016 they amounted to PLN 102.1 million, having grown by 7.2% comparing to 2015. The increase in expenses resulted from higher salaries of the sales network staff (implementation of a new career path in the second quarter of 2015) and an increased provision for unused paid vacation and recognition of provisions for costs of non-competition agreements of Members of the Management Board of the 9th term of office.

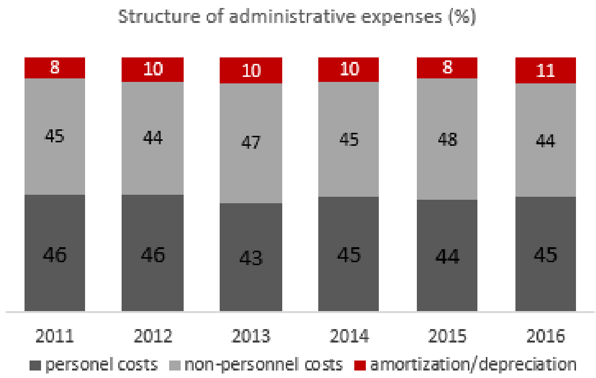
In 2016 operating expenses reached PLN 98.9 million and were 4.5% lower than in 2015. As for non-personnel expenses, costs of payments to the Bank Guarantee Fund decreased the most, as apart from the mandatory fee and the prudential fee these costs included amounts used by the Bank Guarantee Fund for payment of guaranteed funds:

- PLN 0.8 million in 2016 - amount used for payment of guaranteed funds to depositors of Bank Spółdzielczy in Nadarzyn under Resolution of the Management Board of Bank Guarantee Fund no. 308/DGD/2016;
- PLN 11.9 million in 2015 - amount used for payment of guaranteed funds to depositors of Spółdzielczy Bank Rzemiosła i Rolnictwa in Wołomin under Resolution of the Management Board of Bank Guarantee Fund no. 87/DGD/2015.

Moreover, in 2016 non-personnel expenses were increased by the tax on certain financial institutions, which amounted to PLN 4.8 million in 2016.

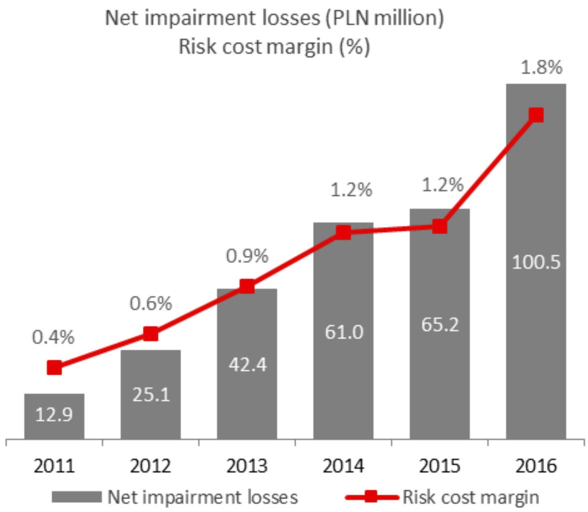
In 2016 amortization expenses amounted to PLN 23.9 million and were by PLN 31.4% higher than in 2015. The growth resulted from higher investment expenditure resulting from the development of the Group and modernization of IT solutions.





Net impairment losses

In 2016 costs of recognition of impairment losses reached PLN 100.5 million and were by 54.2% higher than a year before, as in 2015 they had amounted to PLN 65.2 million. This item was affected by higher impairment losses on loan receivables with indications of impairment (mostly personal loans), where the impairment loss amount was by PLN 44.3 million, i.e. 75.5% higher than in 2015. The increase resulted from changes in the cash loan and installment loan portfolio with a higher impairment loss (PLN 82.2 million) and higher IBNR loss (PLN 13.8 million) in 2016.



Impairment loss on loans for individuals grew for the following reasons:

- increase in the value of the loan portfolio with recognized impairment, which results from shifting loans granted in 2013-2016 on vintage curves (portfolio maturity) with a higher curve slope than in curves from previous years;
- risk profile of the portfolio of cash loans and installment loans for years 2013-2016 higher than initially assumed;
- increase in the indicator showing the portfolio coverage with observable inputs in the banking sector.

These factors increase the risk ratios (including PD[10] and LGD[11]), which are regularly reviewed by the Bank based on actual portfolio changes and which are related to IBNR losses.

In 2016 the amount of impairment losses recognized in loans granted to institutions was by PLN 9.0 million lower than in 2015, which resulted from the release of a portion of impairment losses related to the situation in the portfolio which was better than expected (sale of NPL portfolio).

[10] Probability of loan classification to impaired portfolio.
[11] The estimated loss (in percentage terms) in case of loan impairment.

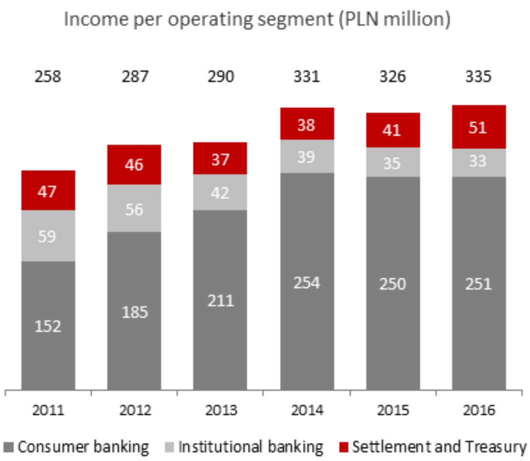
Net impairment losses (PLN'000)	2016		2015		Total change 2015/2016	
	Total	including IBNR	Total	including IBNR	PLN '000	%
including:	(100,496)	(11,817)	(65,158)	(2,149)	(35,338)	54.2 %
individuals	(102,931)	(13,762)	(58,639)	(3,427)	(44,292)	75.5 %
overdraft facilities	(183)	35	(741)	109	558	(75.3)%
cash loans and installment loans	(95,980)	(13,784)	(53,032)	(4,792)	(42,948)	81.0 %
mortgage loans	(5,513)	(100)	(2,874)	106	(2,639)	91.8 %
real estate loans	(709)	126	(1,722)	1,047	1,013	(58.8)%
overdraft faciliies on credit cards	(546)	(39)	(270)	103	(276)	102.2 %
institutional clients	2,456	1,966	(6,567)	1,275	9,023	(137.4)%
local government	(21)	(21)	48	3	(69)	(143.8)%

7.2. Performance in operating segments

Information regarding operating segments is reported on the same basis as is used internally in reports presented to the Management Board of the Bank for the purpose to allocate resources to segments and evaluate their performance.

For management purposes, the Group's operations have been divided into segments in accordance with products sold, services provided and types of clients. The following operating segments have been identified: consumer, institution, settlement and treasury.

Dividend income has been allocated to the settlement and treasury segment in information regarding consolidated income statement for the year ended 31 December 2016. The performance data for 2015 have been restated to ensure comparability.

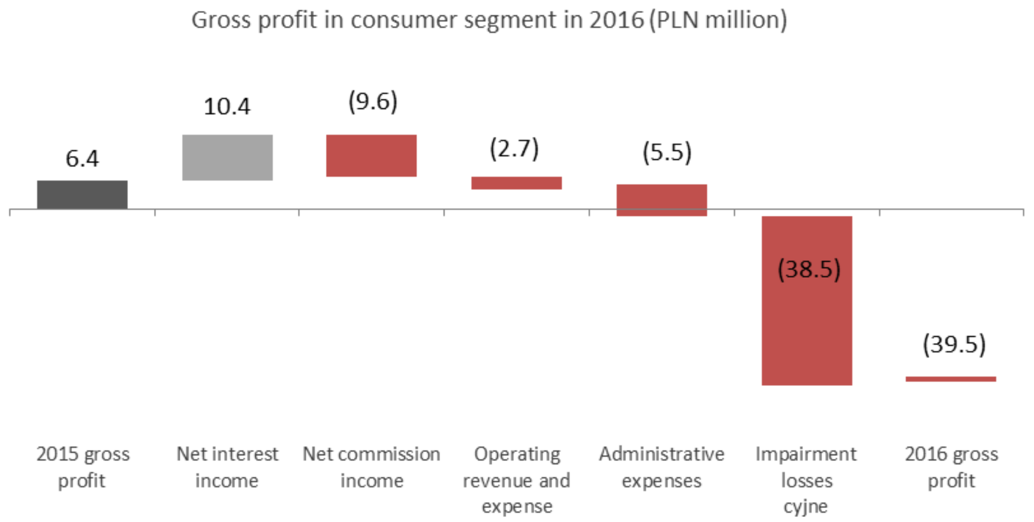


Figures not allocated to segments on the income level: PLN 4.0 million in 2016 and PLN 1.8 million in 2015.

Consumer segment

From management accounting perspective the consumer segment offers products targeted at individuals and microenterprises (individuals carrying out business activities). The offer consists of saving and settlement accounts, savings accounts, term deposits, consumer loans (including cash loans and overdrafts), mortgage loans (including housing loans and mortgages), debit and credit cards, insurance products and investment funds. It is sold through traditional distribution channels in a countrywide network of branches and sales points (including the sales network of Poczta Polska and financial agents), Pocztowy24 Internet banking, PocztowySMS service and a Contact Center.

In 2016 the consumer segment generated gross profit of PLN (39.5) million vs. PLN 6.4 million in 2015, mainly due to a growth in impairment losses on loans and advances (mostly on consumer loans).



Key gross profit drop drivers in the consumer segment:

- An increase in net interest income. Net interest income constituted the key source of segment income. It amounted to PLN 231.2 million and increased by PLN 10.4 million as interest rates remained low and reduced costs generated on deposits from 1.3% in 2015 to 1.0% in 2016.
- A decrease in the net commission income. The consumer segment made PLN 19.8 million on fees and commissions, which denotes a PLN 9.6 million drop vs. the prior year. Key drop drivers included: a provision recognized for refund of investments to clients related to proceedings instigated by Office for Competition and Consumer Protection, reduced commissions on the maintenance of current accounts, and lower income on cash transactions, Infokonto service, as well as an increase in costs of cash and credit cards arising from a growing number of issued cards (due to growing popularity of contactless card transactions and development of the acceptance network).
- Higher administrative expenses. In 2016 the consumer segment costs reached PLN 183.6 million, which denotes a PLN 5.5 million growth year-on-year. Assigning additional non-personnel expenses to the consumer segment (the cost of the so-called banking tax), an increase in personnel expenses in the sales support area and the recognized provisions for unused annual leave were the key growth factors.
- Higher net impairment losses. In 2016 it reached PLN 102.6 million [12] vs. PLN 64.1 million in 2015 as a result of a growth in impairment losses on loan receivables with indications of impairment (mostly cash and installment loans originated in 2013-2016).

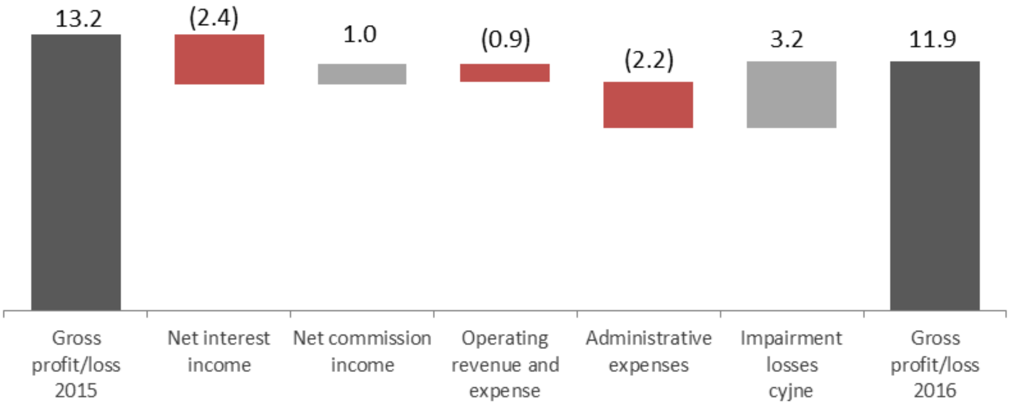
Institutional segment

For management accounting purposes institutional segment includes operating profit/loss from services provided to business entities with legal personality, individuals and entities with no legal personality carrying out business activities under applicable regulations and central and local administration entities. The Group's offer for these clients includes credit and deposit products and settlement services with products aimed at improving cash management efficiency. The products are offered both through Bank's own network and that of Poczta Polska.

In 2016 the institutional segment generated a gross profit of PLN 11.9 million versus PLN 13.2 million in 2015 (a decrease of PLN 1.3 million).

[12] The data include net impairment losses regarding Microenterprises. In 2016 they amounted to PLN 0.8 million, while in 2015 PLN (5.2) million.

Gross profit in institutional segment in 2016 (PLN million)



The institutional segment profit was driven by the following items:

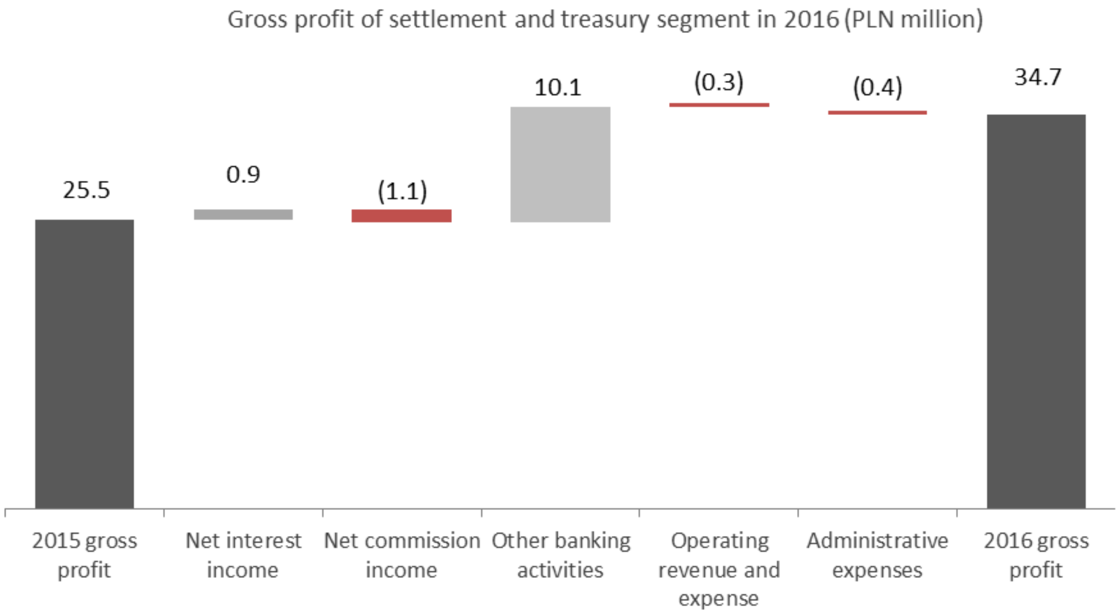
- A decrease in net interest income. The segment generated PLN 21.4 million, which denoted a PLN 2.4 million decrease year-on-year, mostly as a result of reducing the scope of loan and deposit operations in this segment, in accordance with the strategy.
- An increase in net fee and commission income. The segment generated a net commission income of PLN 12.2 million, i.e. by PLN 1.0 million more (i.e. by 8.9%) than in the prior year. The highest increase in commission income resulted from opening and maintaining bank accounts for sole proprietors, sealed deposits and Giro Płatność orders.
- A growth in administrative expenses. They amounted to PLN 22.9 million, i.e. PLN 2.2 million more than in the prior year, as a result of a growth in personnel expenses, i.e. severance paid to some Management Board members of 9th office term, and increased depreciation and amortization arising from Bank's growth and improvement of the existing IT solutions allocated to the segment.
- Improvement in net impairment losses. In 2016 they were positive and amounted to PLN 2.2 million vs. PLN (1.0) million in 2015 as a result of a gain on sales of a group of loan receivables.

Settlement and treasury segment

Settlement and treasury segment in management accounting includes:

- Gain/loss on operating activities covering settlement services. Key settlement services include: processing documents regarding social insurance and tax payments; cashless transfers of social insurance benefits to beneficiaries and cash payments included in interbank settlements.
- Gain or loss on financial instruments measured at fair value through profit or loss, gain or loss on foreign exchange transactions and gain or loss on other financial instruments.
- Net interest income. The figure includes transactions in the interbank market (e.g. deposits), purchases and sales of securities (Treasury bonds, debt instruments issued by the National Bank of Poland, bank bonds), as well as sell-buy-back and buy-sell-back transactions and derivative transactions such as FRA, IRS or swap. Client funds obtained by operating segments are repurchased at a transfer rate and the funds to finance their credit operations are sold to these segments.

In 2016 the settlement and treasury segment generated a gross profit of PLN 34.7 million versus PLN 25.5 million in 2015 (an increase of approx. 36.0%).



The key gross profit drivers in the settlement and treasury segment in 2016:

- An increase in net interest income. It amounted PLN 12.4 million and was PLN 0.9 million higher than in the prior year.
- A decrease in net fee and commission income. It amounted to PLN 14.4 million and was PLN 1.1 million (7.0%) lower than in the prior year. The drop was seen mostly with regard to income generated from social insurance premium transfers and Wpłaty Standard.
- An increase in other net banking income. The item includes: gain or loss on financial instruments measured at fair value through profit or loss, gain or loss on foreign exchange transactions and dividend. Gain or loss on other financial instruments amounted to PLN 23.6 million vs. PLN 13.5 million in 2015 as a result of generating income on sales of shares in VISA Europe to VISA Inc. (the acquisition of VISA Europe by VISA Inc.). As a result of the transaction, the Group recognized income of PLN 16.9 million.
- A slight increase in administrative expenses. In 2016, the segment generated costs of PLN 15.4 million vs. PLN 15.0 million in 2015.

7.3. Key performance ratios

Key performance ratios of the Bank Pocztowy S.A. Capital Group			
	31.12.2016	31.12.2015	Change 2016/2015
Net ROE (%)[1]	0.5	6.9	(6.4) p.p.
Net ROA (%)[2]	0.04	0.5	(0.46) p.p.
Costs including amortization / income (C/I)[3] (%)	67.6	66.8	0.8 p.p.
Net interest margin (%)[4]	3.7	3.6	0.1 p.p.
CAR (%)[5]	14.4	14.4	0.0 p.p.
NPL – the share of impaired loans and advances in the credit portfolio[6] (%)	8.9	7.0	1.9 p.p.

1. *Net ROE calculated as a net profit for the period from 1 January 2016 to 31 December 2016 to average equity (calculated as the average of equity at the end of a given year and at the end of the previous year) taking into account the net profit for a given year.*
2. *Net ROA calculated as a net profit for the period from 1 January 2016 to 31 December 2016 to average assets (calculated as the average of assets at the end of a given year and at the end of the previous year).*
3. *Costs including amortization and depreciation/Income (C/I) calculated as the general and administrative expenses including amortization and depreciation to total income (net interest income, net fee and commission income, gain/loss on financial instruments measured at fair value through profit or loss, gain/loss on foreign exchange transactions, gain/loss realized on other financial instruments, other operating revenue and expenses).*
4. *Net interest margin calculated as a relation of net interest income for a given period to average assets (calculated as average daily balance of assets). Net interest margin calculated based on two average assets balances: at the end of the current year and of the prior year) amounts to 3.8% for 2016 and 3.4% for 2015.*
5. *CAR and Tier 1 values have been calculated in accordance to the Regulation (EU) no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms. Separate data.*
6. *The share of loans with recognized impairment (NPL) in the loan portfolio, calculated as a relation of loans with recognized impairment to total (gross) loans and advances granted to customers.*

In 2016 the Group generated net ROE of 0.5%, which denoted a year-on-year drop by 6.4 p.p., due to a decrease in net profit.

A growth in income (by 3.5% y/y) accompanied with an increase in operating expenses (by 3.6% y/y) translated into a slight deterioration in Cost/Income ratio (C/I) ratio. In 2016 C/I ratio amounted to 66.8%, i.e. was by 0.8 p.p. higher than in 2015.

At the end of 2016 the share of loans with recognized impairment (NPL) in the credit portfolio was 8.9% vs. 7.0% a year before. The 1.9 p.p. increase resulted mostly from a growth in Group's exposure concentration on cash and installment consumer loans and the portfolio reaching its maturity. The carrying amount of cash and installment loans with recognized impairment increased in 2016 by PLN 107.6 million (from PLN 185.6 in 2015 to PLN 293.2 million in 2016).

7.4. Statement of financial position of the Capital Group as at 31 December 2016: key balance sheet items

As at 31 December 2016 the balance sheet total of the Group amounted to PLN 6,936.6 million and was by PLN 276.5 million, i.e. by 3.8% lower than at the end of 2015.

Key balance sheet items of the Bank Pocztowy S.A. Capital Group (PLN'000)

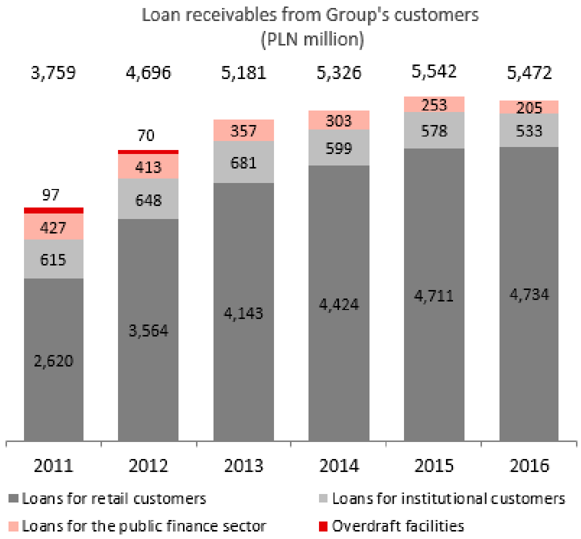
	31.12.2016	Share (31.12.2016)	31.12.2015	Share (31.12.2015)	Change 2016/2015 (PLN '000)	(%)
Cash in hand and deposits with the Central Bank	65,365	0.9%	426,875	5.9%	(361,510)	(84.7)%
Receivables from other banks	45,898	0.7%	45,346	0.6%	552	1.2 %
Receivables from securities purchased under reverse repo and buy-sell-back agreements	0	0.0%	19,794	0.3%	(19,794)	(100.0)%
Loans and advances granted to customers	5,154,339	74.3%	5,312,882	73.6%	(158,543)	(3.0)%
Investments in financial assets	1,464,557	21.1%	1,248,037	17.3%	216,520	17.3 %
Net non-current assets	118,973	1.7%	100,137	1.4%	18,836	18.8 %
Other assets	87,434	1.3%	59,959	0.9%	27,475	45.8 %
Total assets	**6,936,566**	**100.0%**	**7,213,030**	**100.0%**	**(276,464)**	**(3.8)%**
Liabilities to the Central Bank	2	0.0%	10	0.0%	(8)	(80.0)%
Liabilities to other banks	21,856	0.3%	34,440	0.5%	(12,584)	(36.5)%
Liabilities from securities sold under repo and sell-buy-back agreements	1,040	0.0%	154,017	2.1%	(152,977)	(99.3)%
Liabilities to customers	5,763,014	83.1%	5,742,377	79.6%	20,637	0.4 %
Liabilities arising from issue of debt securities	355,641	5.1%	503,500	7.0%	(147,859)	(29.4)%
Subordinated liabilities	142,818	2.1%	141,887	2.0%	931	0.7 %
Other liabilities	128,753	1.9%	94,314	1.3%	34,439	36.5 %
Total liabilities	**6,413,124**	**92.5%**	**6,670,545**	**92.5%**	**(257,421)**	**(3.9)%**
Total equity	523,442	7.5%	542,485	7.5%	(19,043)	(3.5)%
Total liabilities and equity	**6,936,566**	**100.0%**	**7,213,030**	**100.0%**	**(276,464)**	**(3.8)%**

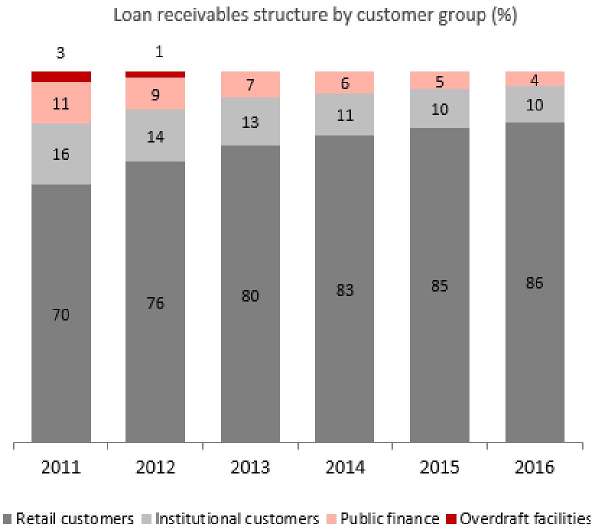
Other assets include: Financial assets held for trading, hedging financial instruments, net deferred income tax assets, other assets.
Other liabilities include: Financial liabilities held for trading, hedging derivatives, provisions, current income tax liabilities, other liabilities.

Assets

The following changes occurred in the structure of Group's assets in 2016:

- The balance of cash and cash equivalents in the Central Bank decreased. It amounted to PLN 65.4 million, i.e. PLN 361.5 million less than in December 2015, mainly as a result of a drop in clients' funds (including Poczta Polska S.A.) and in funds obtained on the interbank market. Consequently, their share in assets decreased from 5.9% at the end of 2015 to 0.9% in 2016.
- The value of the key item in the Group's assets, i.e. net loans and advances granted to clients decreased. As at 31 December 2016 they amounted to PLN 5,154.3 million and dropped by PLN 158.5 million during the year. They accounted for 74.3% of Group's total assets (vs. 73.6% at the end of 2015).
- The value of investments in financial assets increased. They amounted to PLN 1,464.6 million vs. PLN 1,248.0 million as at 31 December 2015. As at 31 December 2016, investments in financial assets increased by PLN 216.6 million (17.3%) vs. 31 December 2015, mostly due to an increased investment of the Group in Treasury bonds.

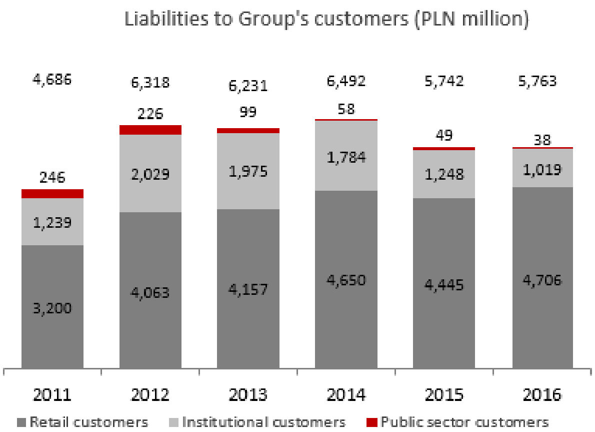


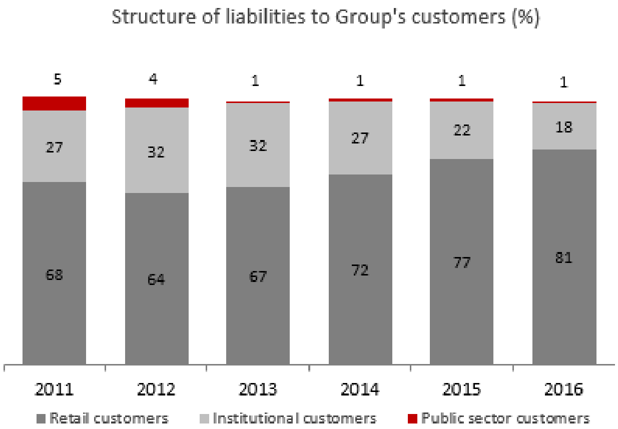


Equity and liabilities

The following changes occurred in the structure of Group's equity and liabilities in 2016:

- Liabilities from securities sold under repo and sell-buy-back agreements decreased. As at 31 December 2016 they amounted to PLN 1.0 million vs. PLN 154.0 million at the end of 2015. Sell-buy-back and repo transactions were concluded on Treasury bonds.
- The value of liabilities due to issue of debt securities increased. As at 31 December 2016 they amounted to PLN 355.6 million vs. PLN 503.5 million at the end of 2015. Liabilities from issues of debt securities decreased by PLN 147.9 million (29.4%) as a result of redemption of B2 series ordinary bonds.





8. Other information required pursuant to Article 111a of the Banking Law

Bank Pocztowy S.A. is a retail bank providing financial services to consumers and institutional clients.

The Bank and all its subsidiaries have their registered offices in the Republic of Poland.

The Bank has been granted no financial support from public funds, in particular under the Act on granting the support for financial institutions by the State Treasury of 12 February 2009 (Journal of Laws of 2016 item 1436).

The Bank has concluded no agreements referred to in Article 141t of the Banking Law.

Consolidated data		
	31.12.2016	31.12.2015
Employment (FTE)	1,546	1,618
Sales[1] (PLN'000)	522,686	537,276
Gross profit (PLN '000)	7,312	42,879
Income tax	(4,802)	(8,948)
Net ROA	0.04	0.5

[1]Interest income, fee and commission income, dividend income, income on financial instruments measured at fair value through profit or loss, income on foreign exchange transactions (including derivatives), investment income, other operating income.

9. Management of key risk types

9.1. Risk management objectives and principles

The key objective of risk management in the Group is to ensure security of funds deposited by its clients as well as effective accomplishment of the Group's strategic objectives through decisions focused on maximization of income generated over a longer time horizon, with an acceptable level of accompanying risks.

Risk management in the Group is an integrated process based on supervisory requirements and internal regulations approved by the Supervisory and Management Board of the Bank. Internal regulations in force are reviewed on a periodic basis, taking into account the developments in the Group's external and internal environment.

The Group has adopted a three-level system of organizing internal risk management regulations.

The general risk management framework for 2016 has been determined in the following documents adopted by the Supervisory Board:

- General Risk Management Policy of Bank Pocztowy S.A.;
- General Capital Management Policy of Bank Pocztowy S.A.;
- Growth Strategy of Bank Pocztowy S.A. for 2015-2018;
- Financial Plan of Bank Pocztowy S.A. for 2016;
- Risk Management Strategy of Bank Pocztowy S.A. for 2016.

Individual risk management policies, approved by the Management Board, provide detailed guidance in this regard. They delegate duties to individual Departments and Offices and provide detailed guidance. Based thereon, detailed operating procedures with descriptions of individual activities (including controls) to be performed by the Departments, Teams and Positions, have been developed.

The risk management system includes:

- the Supervisory Board;
- the Management Board;
- risk management committees established by the Management Board pursuant to internal regulations in force;
- organizational units managing individual risk types;
- control units (including the internal audit and compliance unit);
- other organizational units;
- selected organizational units of the subsidiaries.

The Supervisory Board oversees the risk management system and individual risk management process control, approving its key objectives and guidelines.

The Management Board is in charge of overall risk management in the Group as well as strategic decisions affecting the risk scale and structure. The Management Board approves risk management approach for each risk type, to include risk identification, measurement, monitoring and control, reporting, preventive measures, as well as review and verification of selected risk management processes.

Risk management committees in the Bank are established by the Management Board and participate in the risk management process. Their other roles include consulting and making recommendations for the Management Board with regard to management strategies for a given risk type, principles and procedures regulating the management f various risk types as well as making decisions within the scope of authorization delegated by the Management Board. This concerns, in particular, determining limits and monitoring compliance therewith as well as taking credit decisions in accordance with the limit-related decision-making system adopted by the Bank.

Due to a broad scope and interrelations among different risk types, each type has its leading unit in charge of coordination of its management. These units are responsible for identification, measurement, monitoring and coordination of preventive measures regarding each risk type. Their other tasks include development of risk management procedures applicable to individual stages of the process.

The Bank has an internal audit unit in charge of independent and unbiased audit and assessment of adequacy and effectiveness of the internal control system, procedures and controls, as well as consulting the Bank management system to include effectiveness of its operational risk management. Additionally, to ensure compliance with the applicable regulations, laws and standards, the Bank has established a separate compliance unit in charge of compliance risk management.

The target risk structure at the level of the Bank and the Capital Group depends on the defined risk appetite. The risk appetite determines the readiness of the Bank and the Group to assume a specific risk within a determined time horizon and it is subject to acceptance by the Management Board. The risk appetite is a substantial element of the Bank's Strategy and Financial Plan approved by the Supervisory Board.

Identification and measurement of each risk type result in determining those which are material for the Group, classifying them from the permanent materiality assessment perspective (permanently and temporarily material risks) and for the purpose of capital coverage.

The following risk types are classified as permanently material for the Group:

- credit risk;
- operational risk;
- interest rate risk related to the banking book;
- liquidity risk.

Additionally, the Group identifies the following material risk types:

- strategic risk;
- compliance risk;
- business cycle risk;
- outsourcing risk;
- reputational risk;
- residual risk;
- concentration risk;
- price risk related to debt instruments in the trading book.

In 2016 activities of the Group complied with regulatory requirements arising from Regulation of the European Parliament and of the Council (EU) no. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending the Regulation (EU) no. 648/2012 and Directive of the European Parliament and of the Council no. 2013/36/EU of 26 June 2013 on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC and canceling Directives 2006/48/EC and 2006/49/EC.

9.2. Credit risk

NPL 8.9%

+ 1.9 p.p. y/y

Credit risk is the risk assumed by the Group under credit transactions and resulting in its inability to recover the amounts disbursed, loss of income or a financial loss. Its level is affected among others by quality of development and launch of a loan product, loan granting process and measures reducing the probability of losses. The Group's credit risk includes both counterparty and settlement risk.

When developing its current credit risk management policy, the Group aims to maintain the risk appetite level, i.e. NPL, NPL cover ratio and the vintage curve. Other factors taken into account include maintaining an appropriate level of equity, compliance with the credit limits set by the Group, analyzing both strengths and weaknesses of the Group's lending process and anticipating the opportunities and threats for its further growth. The Group's acceptable credit risk policy also takes into account cyclicality of economic processes and changes in the credit portfolio itself.

The following principles have been adopted for the credit risk management process:

- analyzing credit risk of individual exposures, the entire portfolio and the capital requirement related to credit risk,
- applying internal and external limits arising from risk appetite in various areas of the credit portfolio and from the Banking Law and implemented recommendations of Polish Financial Supervision Authority, respectively;
- functions related to direct analysis of applications, risk assessment and credit related decision making are separated from those focused on client attraction (sales of banking products);
- creditworthiness is the main criterion underlying all credit transactions with clients;
- credit decisions are made in the Bank in accordance with procedures and competences determined in internal regulations on credit risk assessment and credit decision making;
- from conclusion to full settlement, each credit transaction is monitored in terms of utilization, timely repayment, legal security, equity and organizational relationships of the obligor and, in the case of institutional clients, also in terms of their current economic and financial position;
- developments in the real estate market as well as the legal and economic assumptions and framework for valuation of property provided as collateral for credit exposures are monitored on a periodic basis.

Credit risk management in the Group is based on written instructions and procedures defining the methods of identification, measurement, monitoring, limiting and reporting of credit risk. The regulations determine the scope of competences assigned to each unit of the Group in the credit risk management process.

In order to determine the credit risk level, the Group uses the following measures:

- probability of default (PD);
- recovery rate (RR);
- loss given default (LGD);
- loss identification period (LIP);
- share and structure of non-performing loans (NPL);
- coverage of non-performing loans with impairment losses (NPL coverage);
- scoring model efficiency measures (among others GINI, PSI ratio);
- cost of risk.

The Group carries out regular review of implementation of the adopted credit risk management policy. The following systems and ratios are subject to review and modification:

- internal regulations regarding client's credit risk assessment and monitoring, as well as verification of the value of legal security, which are adjusted to changing market conditions, business specifics of each client type (group), loan purpose and determination of the minimum requirements regarding the obligatory forms of legal security;
- internal system of limiting credit activities and determining decision-making powers regarding loans;
- a system of identifying, assessing and reporting credit risk to Credit Committees, Management and Supervisory Board of the Bank;
- maximum adequacy levels of ratios used to assess credit risk and acceptable forms of own contribution for retail housing loans;
- scoring models and IT tools used in the credit risk management process.

The Group's reporting system includes among others:

- reporting on credit risk level, to include vintage analyses, information regarding the use of limits, quality and efficiency of credit processes;
- reports on stress tests, limit review and back-test analyses for impairment losses;
- analyses of real property market and verification of the current value of security for credit exposures;
- review of implemented credit risk policy.

The Group prepares the following cyclical reports on its credit risk exposure:

- monthly report for the Management Board and Credit Committee of the Bank,
- quarterly report for the Supervisory and Management Board.

Portfolio quality

At the end of 2016 the share of exposures with recognized impairment in the total portfolio amounted to 8.9% and was 1.9 p.p. higher than at the end of 2015, on the one hand as a result of recognizing more impaired loans and on the other hand, due to reduced gross carrying amount of loans and advances. The increase in the value of impaired loan portfolio resulted from Bank's focus on consumer loans market, which has given rise to a higher risk with assumed high profitability. Additionally, please note the risk profile regarding the cash and installment loan portfolio for years 2013-2016 being higher than initially assumed. Following the risk increase identification, in 2016 the Bank initiated measures aimed at its reduction.

Portfolio quality – the share of impaired loans in the gross credit portfolio

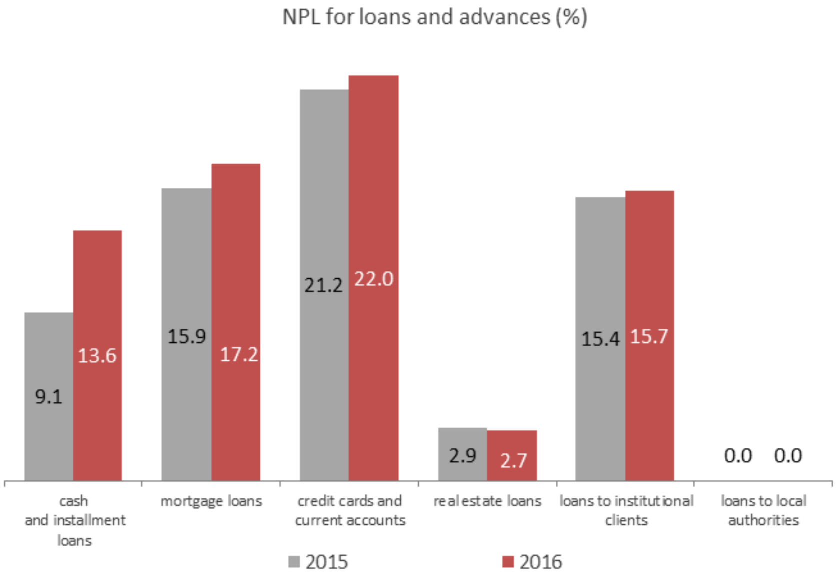
	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016	Change 2016/2015
Capital Group total	**4.7%**	**5.4%**	**6.1%**	**7.0%**	**8.9%**	**1.9 p.p.**
for individuals	4.4%	4.7%	5.6%	6.4%	8.5%	2.1 p.p.
for institutional customers	9.5%	12.3%	13.0%	15.4%	15.7%	0.3 p.p.
for local government bodies	0.0%	0.0%	0.0%	0.0%	0.0%	0.0 p.p.

Portfolio quality – impaired loans balance (PLN'000)

	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016	Change 2016/2015
Capital Group total	**221,777**	**277,241**	**325,391**	**389,838**	**486,171**	**96,333**
for individuals	157,472	193,465	247,265	300,766	402,603	101,837
for institutional customers	64,305	83,776	78,026	89,072	83,568	(5,504)
for local government bodies	0	0	100	0	0	-

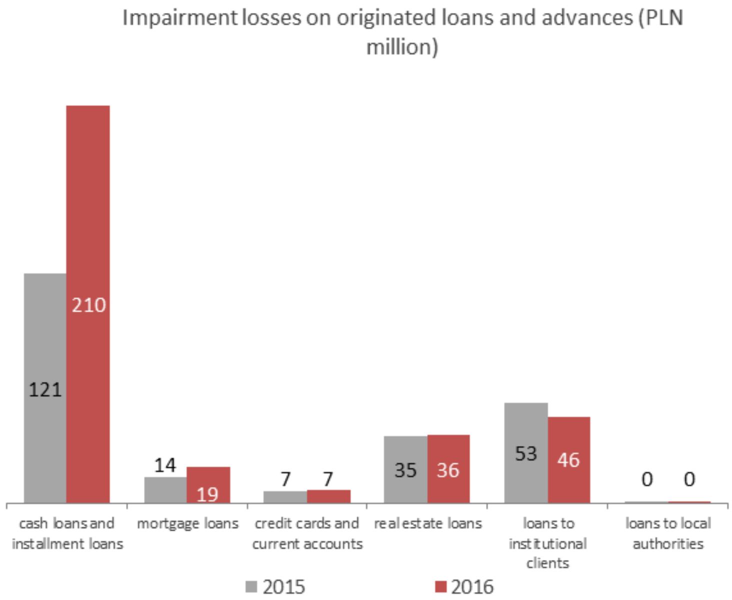
Therefore, at the end of December 2016 the amount of loans with recognized impairment was PLN 96.3 million higher than at the end of 2015. Customer loans are the source of the entire increase, since in the institutional client segment the amount of impaired loans decreased.

Below please find NPL per product group:



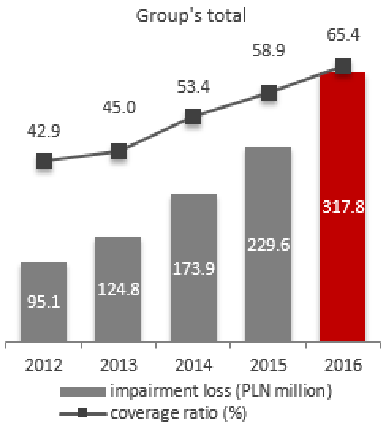
Impairment losses

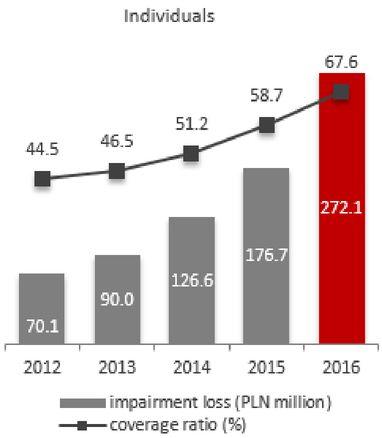
At the end of December 2016 the carrying amount of impairment losses for the Group's loan portfolio was PLN 317.8 million and was 38.4% higher compared to the end of 2015, mostly as a result of increased impairment of cash and installment loans resulting from quality deterioration of that portfolio.

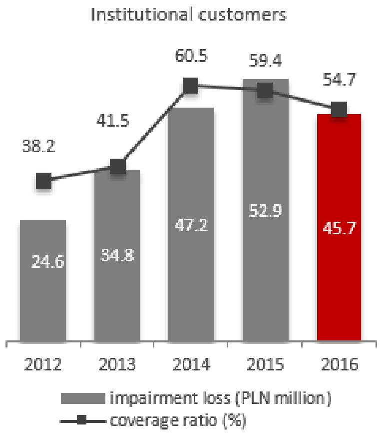


At the end of December 2016 the coverage ratio reached 65.4% and was 6.5 p.p. higher than at the end of December 2015. The ratio amounted to 67.6% for consumer loans and to 54.7% for institutional loans.

The calculation includes appropriation to IBNR.







9.3. Credit policy

The credit policy was updated as a result of regular reviews of the loan process, to include compliance with internal regulations, the necessity to update the credit risk parameters arising from the PFSA recommendations and the amended Risk Strategy for 2016.

Consumers

The key changes introduced in 2016 with regard to the consumer loan portfolio include:

- amended assumptions regarding low-value loans granted upon completion of a statement of means;
- building new scoring models;
- amended risk class definition to improve client assessment diversification;
- classifying minimum household expenses and interest rate risk buffer in accordance to loan periods;
- rebuilding the consumer loan sales structure to diversify the portfolio;
- developing new cash loan collateralizing rules to better adjust to customer's risk profile;
- developing detailed principles and procedures regarding the monitoring of the value of real property used as collateral when granting consumer loans;
- amending "Principles of limiting credit activities with regard to exposure concentration" - amended internal limits for consumers following a periodic review of limits and adjustments regarding implementation of Recommendation C.

At the same time, the Bank is working on implementation of changes to the cash loan process in 2017, involving among others introduction of a new scoring model and amendments to loan policy, comprising linking the maximum exposure to customer's income and risk profile and changing the sales model intended for Bank's customers.

Institutional clients

Key changes regarding the institutional clients portfolio include:

- verifying assumptions that underlie the scenario analysis applied to evaluate individually material exposures;
- unifying the loan policy with regard to classification of exposures as individually material;
- developing detailed principles and procedures regarding the monitoring of the value of commercial property;
- amending "Principles of limiting credit activities with regard to exposure concentration" - amended internal limits for institutional clients following a periodic review of limits and adjustments regarding implementation of Recommendation C.

9.4. Liquidity risk

Liquidity risk is the risk of the Group companies losing the capacity to pay its liabilities on a timely basis due to an unfavorable structure of its assets and liabilities and cash flow mismatch. Liquidity risk may arise from a cash flow mismatch, sudden withdrawal of deposits, concentration of funding sources and the credit portfolio, inadequate level of liquid assets, limited liquidity of assets, the Group's clients' default on their obligations or other unexpected developments in the financial market.

The Group's liquidity risk is managed at the level of the Bank as the liquidity risk assumed by the subsidiaries is immaterial considering the nature of their business.

The objective of liquidity risk management is to balance proceeds and payments of funds under on- and off-balance sheet transactions in order to ensure cost-effective funding sources, generating of cash surpluses and their appropriate use. The Bank builds the structure of its assets and liabilities so as to ensure the achievement of assumed financial ratios with the liquidity risk level accepted by the Bank.

The following principles have been adopted for the liquidity risk management process:

- maintaining an acceptable liquidity level based on an appropriate portfolio of liquid assets,
- stable funds being the key source of funding for the Bank's assets;
- undertaking initiatives aimed at maintaining the liquidity risk level within the accepted risk profile;
- maintaining supervisory liquidity measures above the defined limits.

Liquidity risk management in the Bank is based on written policies and procedures defining the methods of identification, measurement, monitoring, limiting and reporting of liquidity risk. The regulations also determine the scope of competences assigned to each unit of the Bank in the liquidity risk management process. In order to ensure high standards of liquidity risk management, compliant with best banking practices, at least once a year the Bank reviews and verifies the policies and procedures, including internal liquidity limits.

In order to determine the liquidity risk level, the Bank uses a number of measurement and assessment methods, such as:

- contractual and actual liquidity gap method,
- deposit base stability and concentration check,
- surplus of liquid assets over unstable liabilities,
- structural limits;
- stress testing.

With a view to mitigating the liquidity risk, the Bank uses liquidity limits and thresholds for selected measures, including liquidity ratios or the mismatch between accumulated actual cash flows generated by assets and liabilities in individual time ranges.

Pursuant to Resolution No. 386/2008 of the Polish Financial Supervision Authority of 17 December 2008 on liquidity requirements for banks (as amended), the Bank monitors and maintains the liquidity measures above the statutory minimum. In 2016, the Bank fulfilled the requirements concerning the minimum supervisory liquidity ratios as specified in the aforesaid Resolution. Since October 2015 the Bank has been obliged to maintain minimum liquidity coverage ratio ("LCR") under Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No. 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions and in conjunction with Regulation of the European Parliament and of the Council (EU) no. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending the Regulation (EU) No. 648/2012. Minimum LCR applicable to the Bank has been 60% as from 1 October 2015, 70% - from 1 January 2016, 80% - from 1 January 2017 and 100% from 1 January 2018.

As at 31 December 2016, liquidity ratios remained within the valid risk limits.

The following table presents supervisory liquidity measures as at individual balance sheet dates.

Liquidity measures	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016	Limit
M1 (PLN '000)	702,417	447,457	694,826	520,331	885,293	0
M2	1.48	1.31	1.49	1.60	2.48	1
M3	4.17	2.88	4.74	4.85	4.13	1
M4	1.19	1.13	1.19	1.16	1.18	1
LCR	-	-	138%	131%	148%	70%[1]

[1/] Value as at 31 December 2016. The minimum supervisory requirement was 60% in the period from 1 October 2015 to 31 December 2015.

The Bank has defined contingency plans to address sudden changes in the deposit base. An analysis of immediately available funding sources shows that in case of a sudden liquidity drop, the Bank is able to obtain sufficient funds without the need to implement its contingency plans. As at 31 December 2016, the Bank's portfolio of liquid assets was sufficient to deal with an actual crisis.

The following tables present realigned liquidity gaps for the Bank.

Realigned liquidity gap in 2016 (PLN'000)	Up to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years
Realigned gap	857,876	(54,102)	42,319	187,290	(1,242,000)	1,395,197
Accumulated gap	857,876	803,774	846,093	1,033,383	(208,617)	1,186,580

Realigned liquidity gap in 2015 (PLN'000)	Up to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years
Realigned gap	701,962	(754)	99,628	53,414	(1,263,874)	1,520,195
Accumulated gap	701,962	701,208	800,836	854,250	(409,624)	1,110,571

Realigned liquidity gap in 2014 (PLN'000)	Up to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years
Realigned gap	899,964	(125,192)	15,914	79,692	(1,439,935)	1,648,591
Accumulated gap	899,964	774,772	790,686	870,378	(569,557)	1,079,034

Realigned liquidity gap in 2013 (PLN'000)	Up to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years
Realigned gap	654,032	(166,771)	(94,812)	(209,737)	(738,356)	2,120,637
Accumulated gap	654,032	487,261	392,449	182,712	(555,644)	1,564,993

Realigned liquidity gap in 2012 (PLN'000)	Up to 1 month	From 1 month to 3 months	From 3 months to 6 months	From 6 months to 1 year	From 1 year to 5 years	Over 5 years
Realigned gap	921,012	(171,412)	(107,579)	(56,248)	(1,452,275)	1,709,584
Accumulated gap	921,012	749,600	642,021	585,773	(866,502)	843,082

9.5. Interest rate risk

Interest rate risk results from the exposure of the Group's financial performance and equity to adverse changes in interest rates.

The Group's interest rate risk is managed at the level of the Bank as the risk assumed by the subsidiaries is immaterial considering the nature of their business.

The interest rate risk arises from:

- mismatch of revaluation dates: the risk is expressed as a threat to the Bank's revenue, mostly interest income, in case of unfavorable changes of market interest rates or significant changes of the balance sheet revaluation structure resulting in changes in the interest gain/loss;
- basis risk arising from imperfect correlation between interest rates on products that generate interest income and expense and have the same revaluation dates;
- yield curve risk where the ratio between the interest rates concerning different periods but the same index or market changes;
- client option risk arising when clients change the amount and timeline of cash flows on assets, liabilities and off-balance sheet items according to their rights arising from loan or deposit agreements, without incurring any additional costs.

The Bank adapts its interest rate risk management to the type and scale of its business. Interest rate risk in the Bank may be related to the banking book and to the trading book.

The objective of interest rate risk management is to build a structure of assets and liabilities ensuring protection of the present value and net interest income of the Bank for the banking book and to obtain financial benefits through transactions on interest rate instruments concluded on own account in the trading book, with the accepted interest rate risk level.

Interest rate risk management in the Bank is based on written policies and procedures, which define the methods of:

- risk identification;
- risk measure calculation (risk measurement);
- risk exposure limiting – determining the acceptable risk level;
- monitoring items and changes in each book, portfolio and the limit use levels;
- risk exposure reporting;
- hedging exposures against interest rate risk.

Interest rate risk related to the banking book is measured and monitored with the use of such risk measures as:

- BPV (Basis Point Value) denoting interest rate risk expressed as a cash value, related to maintaining of a given position when interest rates change by one basis point;
- NII (net interest income) – a change in net interest income representing the difference between interest income and expense with an interest rate change at a specified level;
- BPV gap value in each revaluation range,
- duration: a measure of interest rate risk interpreted as the average duration of an instrument or portfolio,
- early repayment of loans and withdrawal of deposits ratios for each type of products and entities.

Interest rate risk related to the Trading Book is measured and monitored with the use of such risk measures as:

- BPV and BPV gap value in each revaluation range,
- Value at Risk (VaR).

Additionally, the Bank performs stress tests involving sensitivity analysis and examining the effects of interest rate changes on the present value of risk-exposed items based on specified changes in the yield curve, and the effects of changes in interest rates on net interest income of the Group. Under stress tests, the Bank measures its exposure using a variety of interest rate risk scenarios, among others assuming:

- sudden parallel upward and downward shifts on the yield curve;
- sudden changes in the shape of the yield curve (e.g. increasing/decreasing/flat short-term interest rates when medium- and long-term ones change at a different pace or in opposite direction);
- basis risk (including that arising from changes in relations among key market rates);
- potential behavior changes of various types of assets or liabilities under the assumed scenarios.

For the purpose of calculating the Banking Book risk measures, the current value of loans and deposits is determined based on reference rates arising from revaluation dates and liquidity adjustment excluding the commercial margin realized on each product. Additionally, stress tests for downward curve shift purposes are based on the assumption that interest on items sensitive to interest rate risk shall not drop below 0%.

The following tables present the interest rate risk level for the banking book (BPV and stress tests).

Stress test results for +/- 200 b.p. (PLN'000)					
Change in the present value of the banking book	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016
200 b.p. down	(11 802)	(7 837)	(1 034)	69	(32 658)
200 b.p. up	13 052	8 374	4 767	1 359	24 797

BPV in the banking book (PLN '000)					
	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016
BPV	61	40	17	5	144

The following table presents a change in annual net interest income with the rate change by +/-100 b.p. and balance sheet assumed to be stable. The analysis is based on the following assumptions:

- for interest rate decrease: interest rates on loans shall not exceed the interest rate cap determined in applicable laws and interest rates on deposits (both term and current accounts) shall not drop below 0%;
- for interest rate increase: interest on interest-free current accounts shall not increase.

Change in the annual net interest income (PLN '000)					
	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016
100 b.p. down	(16,483)	(18,053)	(51,777)	(29,045)	(31,963)
100 b.p. up	17,255	15,029	17,494	14,589	19,150

In 2016, Bank's trading activities regarding interest rates were limited to transactions on Polish treasury securities denominated in PLN. The Bank did not conclude speculative derivative transactions on its own behalf or derivative transactions with its clients. In 2016 the Bank held no open speculative interest rate positions at day closing.

The following table presents BPV for the trading book.

BPV in the trading book (PLN '000)					
	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016
BPV	0	0	0	0	0

9.6. Currency risk

Currency risk arises from the current and future performance of the Group as well as its equity being exposed to adverse changes in foreign exchange rates.

The Group's currency risk is managed at the level of the Bank as the risk assumed by the subsidiaries is immaterial considering the nature of their business.

The objective of currency risk management is to protect the exchange gain and obtain financial benefits through transactions concluded in FX instruments on own account, with the accepted risk level.

In the process of currency risk management, the said risk in the Bank is measured through:

- calculation of the total position of the Bank,
- calculation of the position in each currency;
- calculation of value at risk (for 99.2% confidence level and ten-day period);
- stress tests.

The following tables present VaR for the currency risk.

VaR measure statistics for currency risk (PLN '000)

VAR	2012	2013	2014	2015	2016
Minimum value	7	7	10	11	4
Maximum value	420	322	210	409	461
Average value	143	34	49	33	157

VaR measure statistics for currency risk (PLN '000)

	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016
VAR	13	28	10	409	235

In 2016 and 2015, the Bank's currency risk was low due to an insignificant share of foreign currency assets and liabilities in the balance sheet total (below 2%). In the period from 31 December 2015 to February 2016, the value of total currency position exceeded 2% of equity. In the period from February 2016 to 31 December 2016, the value of total currency position did not exceed 2% of equity.

9.7. Operational risk

The Group defines operational risk as the risk of a loss arising from inadequacy or unreliability of internal processes, people and systems or from external events. The definition does not include strategic and reputational risks, which are managed separately, but it does include legal risk.

Based on assumptions adopted by the Bank and by the Group, the operational risk management structure includes all organizational units, Branches, Outlets, Microbranches and subsidiaries. All directors manage operational risk in their reporting areas on an ongoing basis.

Ongoing management includes employment of measures aimed at evaluating the risk scale, mitigating the effects of risk events and reducing the probability that the risk will be assumed in the future. The Management Board of the Bank supervises the overall operational risk management process. The Operational Risk Committee is a body consulting the measures employed to change the operational risk level. Coordination of the operational risk management process is the responsibility of the Risk Function.

Each employee is to identify operational risk events pertaining to his/her position that are then collected in a dedicated database. The events are verified by operational risk coordinators on an ongoing basis and monitored by a coordinating unit for the number of events and loss value. Risk monitoring enables employment of measures that reduce the effects of events and implementation of instruments mitigating future risk.

Within the process of risk identification and assessment, the Group has monitored the use of operational risk appetite, key operational risk indicators (KRI) and has regularly performed self-assessment of its operational risk. The self-assessment process includes all organizational units of the Bank and its subsidiaries.

With the view to limit operational risk, the Group has been improving its processes in the Bank structures and in cooperation with subsidiaries and Poczta Polska S.A., on an ongoing basis.

Additionally, operational risk in the Group is mitigated based on procedures related to implementation of the "General Security Policy of Bank Pocztowy S.A." governing such issues as anti-money laundering, fraud prevention, protection of the Bank's resources, continuity of business, protection of personal data, confidential information and business secret as well as security of information in IT systems.

In order to ensure high standards of operational risk management, compliant with best banking practices, once a year the Group reviews the applicable policies and procedures.

9.8. Other risks

In addition to the above risks, the Group identifies and assesses the following risk types:

- compliance risk;
- strategic risk;
- business cycle risk;
- reputational risk;
- outsourcing risk.

Compliance risk

Compliance risk is the risk that in the Group and Bank's subsidiaries, the effects of the non-compliance with the law, internal regulations and codes of conduct will occur. The Group also takes into account compliance risk generated both by the Bank and its subsidiaries, and manages the said risk arising from cooperation between the Bank and Poczta Polska S.A.

The compliance risk management process is based on written principles and procedures, which define the key principles to be followed by the Bank's employees and explain the key processes that identify the said risk, enabling its management at all organizational levels of the Group.

The scope of compliance risk management includes:

- the Group companies' compliance with the law and requirements imposed on banks,
- compliance with appropriate market standards, good practices and codes of conduct adopted by the banking sector,
- preventing money laundering and the funding of terrorism,
- preventing fraud detrimental to the Group.

The compliance risk management process includes risk identification, measurement, monitoring, mitigating and reporting.

Compliance risk identification is a continuous process which is carried out:

- when internal regulations are consulted by the compliance unit for their conformity with the law and requirements imposed on banks,
- based on the outcome of compliance tests and internal regulations compliance self-assessment,
- based on ongoing analyses, including operational risk events base, follow-up functional control and internal audit reports, record of court cases, information on customer complaints related to compliance risk, information from organizational unit heads regarding compliance risks, and fraud reports.

Identified compliance risk events are recorded by the compliance unit in the compliance risk events database.

Compliance risk measurement is performed on a quarterly basis by the compliance unit using a risk scoring model that takes into account the anticipated effects of compliance risk on the organization and its clients, including the probability of its occurrence, and other criteria, such as:

- the number of compliance risk events or actual losses arising from such risk,
- the number of negative press publications and accusations regarding compliance risk in the Bank.

As a result of measurement, risk is scored using a 3-level scale (low, medium or high).

As far as compliance risk arising from cooperation between the Bank and Poczta Polska S.A. is concerned, the compliance unit records compliance risk events and monitors measures aimed at explanation and mitigation of the said risk.

Strategic risk

Strategic risk is the risk to which the Group, its financial performance and equity are exposed due to unfavorable or incorrect strategic decisions, failure to implement or improper implementation of the strategy and developments in the business environment or incorrect response to such changes.
In April 2015 the Supervisory Board of the Bank approved the Development Strategy of Bank Pocztowy S.A. for 2015-2018, whose assumptions have underlain the new direction and pace of growth of the Bank and its subsidiaries.
Significant changes in Group's environment, including a new Strategy of the Poczta Polska Group, the projected participation in governmental programs and failure to achieve all former strategic assumptions have underlain the initiative of developing a new Bank's Strategy, to be prepared by mid-2017 along with a functional strategic management and strategy implementation system.

Business cycle risk

The business cycle risk is the risk of long-term negative effects of an unfavorable stage of the business cycle (e.g. economic slowdown or recession) on the financial performance or equity of the Group.

As the economic standing affects the condition of the banking sector, the Group monitors the macro-economic ratios presenting the situation of the Polish economy on a continuous basis and once a month, prepares detailed macro-economic reports that underlie the decision-making processes in the Bank.

The business cycle risk occurs when the overall economic situation deteriorates. In the case of growing unemployment, taxes, CPI increase (inflation) or its material and prolonged decrease (deflation), or a growth in interest rates or when significant changes in foreign exchange rates occur, the financial standing of customers may deteriorate (including that of the Seniors as target clients), which may translate into a limited capacity to pay their liabilities at their due dates and a reduced demand for the products offered by the Bank (loans, deposits). A slowdown may also result in increased impairment losses on loans and advances or a slower rise in the value of the Bank's credit portfolio due to a drop in demand for loans and in the number of clients that meet the loan granting criteria. Market volatility, economic slowdown and growing unemployment may also result in a significant decrease in the value of the clients' assets, such as real property securing payment of loans originated by the Bank.

Reputational risk

The reputational risk is related to damage to the reputation of the Bank and its subsidiaries in the eyes of its existing and potential clients and stakeholders. This may result in unfavorable effects on the Group's equity, i.e. the negative impact on its planned performance, among others through outflow of the existing clients or no inflow of new clients.

Reputational risk management is to protect the Group's image and minimize the probability of damaging that would adversely affect the Group's capital. Reputational risk management includes:

- ongoing monitoring and analysis of events and media communications that may affect the Group's image and if necessary, implementation of preventive measures,
- regular reporting on the reputational risk level.

Outsourcing risk

Outsourcing risk is a risk third party's negative impact on the continuity, integrity or quality of the Group's operations, its assets or employees.

Outsourcing banking activities and the related banking business processes to third parties necessitates the performance of numerous analyses by the Bank and its subsidiaries, both before establishing a relationship and in the course of cooperation with the insourcer. Outsourcing risk materiality assessment depends on the scope of outsourced activities and the number of entities that perform them for and on behalf of the Group. Outsourcing a broad range of activities to a small number of third parties creates concentration risk and potential problems with timely performance of the activities if the said entities discontinue their services. Due to a large number of insourcers the Group may lose control of the performance of commissioned activities.

Outsourcing risk management in the Bank is based on written policies and procedures defining methods of identification, measurement and monitoring of outsourcing risk. The regulations determine also the scope of competences assigned to each entity in the Group in outsourcing banking and the related banking business processes.

Key information regarding outsourcing risk is regularly presented during Operational Risk Committee meetings.

9.9. Capital adequacy

The Group's capital adequacy is managed on the Bank level. It is aimed to ensure that the Bank's equity level is not lower than the one required by internal and external regulations. The regulations link the required capital level with the scale of operations and risks assumed by the Bank.

Considering the above, the Bank regularly:

- identifies risks material for its business;
- manages key risks;
- determines internal capital to be maintained should the risk materialize;
- calculates and reports capital adequacy measures;
- allocates internal capital to business areas;
- performs stress tests;
- compares its capital needs with the level of equity held;
- integrates the capital adequacy assessment with development of the Bank's Strategy, financial and sales plans.

In 2016 the solvency ratio, Tier 1 and internal solvency ratio of the Bank were above the required regulatory minimum, which was 13.25% for CAR and -10.25% for Tier 1 (PFSA recommendation no. DRB/0735/2/1/2015).

In order to ensure high standards of capital management, compliant with best banking practices, once a year the Bank reviews the applicable policies and procedures.

Equity

For the purpose of equity calculation, the Bank applies methods arising from Regulation of the European Parliament and of the Council (EU) no. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending the Regulation (EU) no. 648/2012 (CRR). The Bank's equity consists of Tier 1 (CET1) and Tier 2 capital.

In 2016, Tier 1 funds in the Bank included:

- equity instruments meeting the conditions specified in CRR;
- agio related to the instruments referred to above;
- retained earnings, to include current period gains or annual profit before a formal decision confirming the final financial performance for a given year following an approval of a competent body;
- accumulated other comprehensive income;
- reserve capital;
- general risk reserve;
- unrealized gains and losses measured at fair value (in amounts including transition regulations referred to in Articles 467 and 468 of the CRR);

- other Tier 1 items as determined in CRR;

and included adjustments due to:

- carrying amount of intangible assets;
- prudential filters and
- other items reducing Tier 1 funds as determined in CRR.

In June 2016 the Bank issued subordinated P1 bonds with the face value of PLN 50 million and maturity date of 8 June 2026. On 23 June 2016, the Bank obtained PFSA's consent to classify the bonds as Tier 2 instruments (file no. DBK/DBK2/7100/5/4/2016/AN).

At the same time, in July 2016 the Bank prematurely redeemed subordinate BP0721 series bonds with the face value of PLN 47.34 million, which, pursuant to PFSA's decision of 4 October 2011 (file no. DNB/IV/7100/2/5/IL/11) have been classified as Tier 2 funds of the Bank. On 23 June 2016 the Bank obtained PFSA's consent to early redemption of the above bonds (file no. DBK/DBK2/7100/4/5/2016/AN).

As at 31 December 2016, Tier 2 funds in the Bank included cash obtained from a subordinate loan received in 2014 from Poczta Polska S.A. and two issues of subordinate bonds (carried out in 2012 and 2016, respectively).

Capital requirements (Pillar 1)

For the purpose of total capital requirement calculation, the Bank applies methods arising from CRR, in particular:

- the standard method of calculating the capital requirement due to credit risk,
- a simplified collateral recognition method where the counterparty's risk weight is replaced with the collateral (its issuer's) risk weight,
- the standard method of calculating the capital requirement due to operational risk,
- the standard method for the risk of credit valuation adjustment,
- the standard method of calculating the capital requirement due to currency risk,
- the maturity method of calculating the capital requirement due to general interest rate risk,
- the standard method of calculating the capital requirement due to special debt instrument price risk,
- the method of calculating the capital requirement due to large exposures.

Since the trading scale was immaterial, the capital requirement regarding market risks for the Bank was PLN 0.00. This means that in the analyzed period the Bank's capital requirement was limited to credit risk, operational risk, currency risk and risk of credit valuation adjustment.

Internal capital (Pillar 2)

When identifying key risks that occur in the Bank's operations, having included the scale and complexity of a given operation, additional risks are considered which, according to the management, are not fully covered by Pillar 1 risks. The identification is to allow optimum adjustment of the internal capital structure to actual capital needs, reflecting the actual risk exposure level.

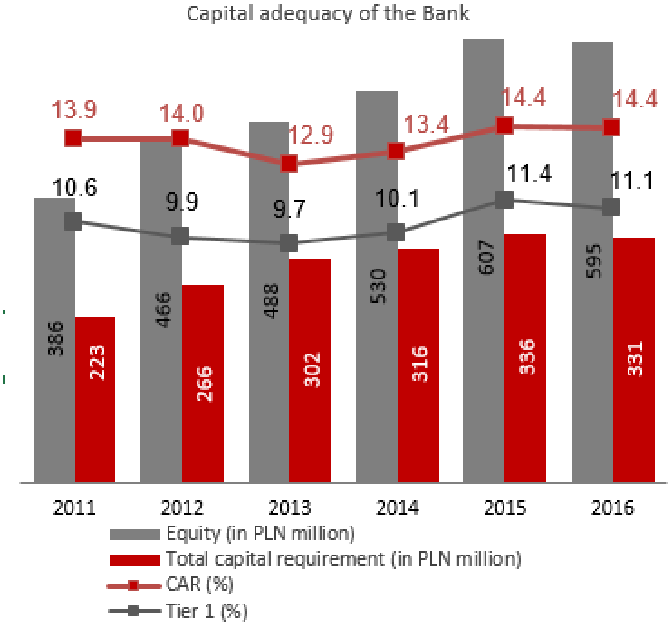
For the additional risk purpose, the internal capital is calculated based on internal methods accepted by the Management Board, which include the scale and specifics of the Bank's operations in a given risk context.

Additionally, when determining the internal capital, the Bank applies a conservative approach with regard to risk diversification among each risk type.

In 2016 the internal solvency ratio of the Group was above the required regulatory minimum.

Disclosures (Pillar 3)

Pursuant to the CRR and to the General Principles of Disclosing Information on Capital Adequacy in Bank Pocztowy S.A. accepted by the Supervisory Board of the Bank, in 2016 the Bank will publish information on its capital adequacy in a separate document.



As at 31 December 2014, 31 December 2015 and 31 December 2016 CAR and Tier 1 ratios were calculated in line with CRR. Pursuant to the above regulations, the Bank has been released from the obligation to determine its consolidated capital requirements. Separate data.
In the remaining years CAR and Tier 1 values were calculated In accordance with Resolution no. 76/2010 of the Polish Financial Supervision Authority of 10 March 2010 regarding the scope and detailed principles of determining capital requirements due to various risk types (as amended). Separate data.

The following tables present a detailed calculation of base figures regarding equity, capital requirements and capital adequacy as at 31 December 2016 and 31 December 2015.

Equity (in PLN'000)		
	31.12.2016	31.12.2015
I Tier 1 capital	**460,126**	**480,417**
Equity instruments paid for	110,133	110,133
Agio	55,356	55,691
Retained earnings, including:	2,724	25,086
- profit (verified profit for the first half of the year)	10,011	25,086
- loss (a portion of not recognized current profit)	(7,287)	0
Accumulated other comprehensive income	(9,273)	11,908
Adjustments related to unrealized gains/losses on instruments in Tier 1 capital*	(789)	(8,146)
Reserve capital	252,862	225,577
General risk reserve	124,345	114,345
Other intangible assets	(74,749)	(53,362)
Additional value adjustments arising from prudent measurement requirements	(483)	(815)
Tier 2 capital	**134,715**	**126,138**
Equity instruments and subordinated loans classified as Tier 2 capital	134,715	93,000
Adjustments related to instruments in Tier 2 capital in the transition period	0	33,138
Equity	**594,841**	**606,555**

* The adjustment regards elimination of a portion of the positive valuation due to unrealized gains in the transition period.

Capital requirements (in PLN '000)	31.12.2016	31.12.2015
Capital requirements for credit, counterparty credit, dilution and settlement risk, including for exposures	288,913	293,382
with 0% risk weight	0	0
with 20% risk weight	3,336	4,128
with 35% risk weight	41,643	43,364
with 50% risk weight	488	2,535
with 75% risk weight	170,588	176,316
with 100% risk weight	60,275	57,036
with 150% risk weight	4,189	5,454
with 250% risk weight	8,371	4,540
other risk weights	0	0
due to payments to central counterparty fund in case of default	23	9
Capital requirement for operational risk	42,319	41,270
Capital requirement for currency risk	0	1,201
Capital requirement for credit valuation adjustment (CVA)	12	51
Total capital requirement	**331,244**	**335,904**
Solvency ratio	**14.4%**	**14.4%**
Tier 1	**11.1%**	**11.4%**

At the end of 2016, solvency ratio was 14.4%, while Tier 1 ratio was 11.1%, which denotes that the Bank's operations ensured maintaining the capital measures above the required regulatory levels.

In 2016 the Bank was granted no financial support from public funds, in particular under the Act on granting the support for financial institutions by the State Treasury of 12 February 2009 (Journal of Laws of 2014 item 158).

10. Organizational and infrastructural development

10.1. Organizational structure of the Bank

The organizational structure of the Bank comprises: Head Office, Branch and other organizational units. The Head Office is the strategic management center, which designs and implements systemic and developmental solutions in the Bank, carries out certain operations and provides services to certain clients.

The Head Office is managed through functionally and organizationally separated areas of Bank's operations that comprise functions and/or other organizational units not included in these functions.

Management Board members supervise the separated operational areas. The supervision includes: correct and efficient performance of tasks assigned to individual functions and/or organizational units not included in the functions and coordination of their cooperation.

The operational areas of the Head Office include:

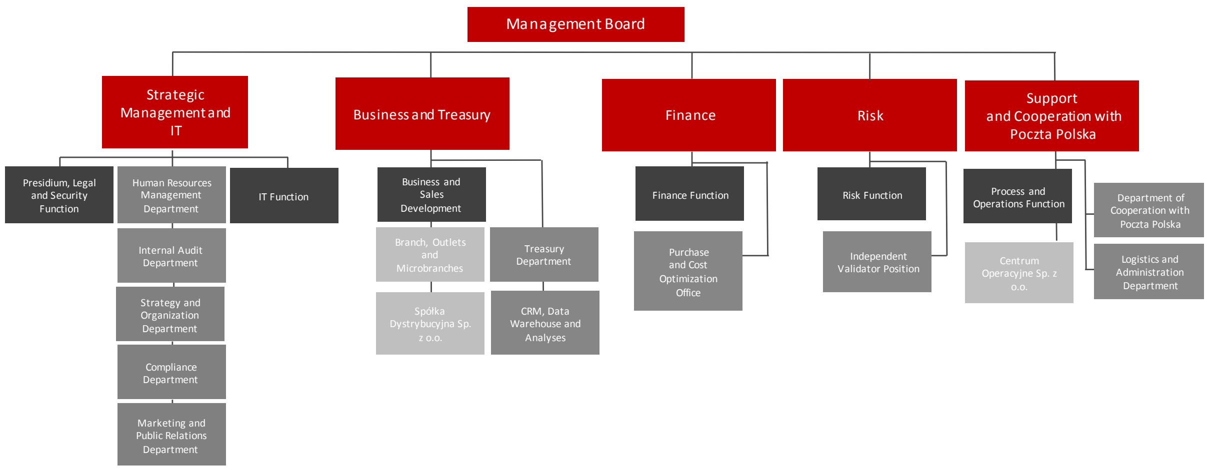
- functions: groups of functionally related organizational units in the Head Office and/or Branch, which design, organize and perform specified processes on the Bank's level;
- organizational units of the Head Office: departments or offices reporting to Management Board members or managing directors and comprising separate internal units (bureaus, teams, individual positions).

The Bank has committees, i.e. groups consisting of managerial staff members, whose activities support those of the Management Board, in particular with respect to managing the risks identified in the Bank.

Advisers to the Chairman of the Management Board, if any, operate within the Head Office. The Management Board Chairman may indicate Head Office units with which a given advisor is obliged to cooperate on an ongoing basis.

In the second half of 2016, a series of organizational changes took place in the Head Office in order to eliminate management weaknesses and excess bureaucracy in certain operational areas, which has resulted in more efficient and simplified organizational structure, adjusted to quick and effective proceeding.

In light of the above, as at 31 December 2016, the organizational structure was as follows:



As at 31 December 2016, five operational areas existed in the Bank and reported to individual Management Board members:

- Strategic Management and IT - reporting to the Chairman of the Management Board;
- Business and Treasury - reporting to a Management Board Member;
- Finance - reporting to a Management Board Member;
- Risk - reporting to a Management Board Member;
- Support and cooperation with Poczta Polska - reporting to a Management Board Member.

Key objectives and tasks assigned to each area:

Strategic Management and IT:

- Presidium, Legal and Security Function: ensuring efficient operation of Bank's bodies, efficient legal support to protect interests of the Bank, ensuring security of IT systems and Bank's resources, to include business continuity solutions and safety of the Bank's operations and clients' funds through preventing fraud, money laundering and terrorism funding;
- Human Resources Management Department: developing employment, training and social policy, ensuring appropriate staff quality and qualifications;
- Strategy and Organization: developing and verifying Bank's strategy and ensuring efficiency of its organizational structure;
- Marketing and Public Relations Department: marketing activities, internal and external communication;
- Internal Audit Office: ensuring tight and effective internal control;
- Compliance Department: ensuring efficient management of compliance risk;
- IT Function: maintaining infrastructure and IT systems on an appropriate level and developing IT systems in accordance with internal client expectations.

Business and Treasury:

- Business and Sales Development Function: developing a desired bank service and product offer and innovative functional and technological solutions essential for meeting business objectives in the consumer, institutional and clearing banking segments, in accordance with the needs of individual business lines, as well as in corporate banking with regard to bank cards and e-money.
- Treasury Department: current liquidity management
- CRM, Data Analyses and Data Warehouse Department: developing CRM and data analysis tools through supply of management information with the use of Data Warehouse.

Finance:

- Finance Function: performing the financial planning process, monitoring implementation of financial plans, keeping accounting records, managing internal resources, statutory reporting, tax services, strategic management of the structure of assets and liabilities and structural liquidity in the Bank.
- Purchase and Cost Optimization Office: correct performance of the purchase process and cost rationalization.

Risk:

- Risk Function: developing an integrated risk and capital management system supporting implementation of the strategy and maintenance of the adopted risk appetite level; developing the risk function strategy related to that of the Bank; developing Bank's credit risk policy and an effective risk monitoring, restructuring and debt collection system; participating in sales of consumer loans, consumer mortgage loans, products for microenterprises and loan products for institutional clients sold in individual distribution channels (with regard to loan decision making);

- Independent Validator Position: developing draft internal principles and procedures regarding model validation, organizing the validation of financial models used by the Bank, carrying out validation of the models in compliance with Model Management Principles.

Support and Cooperation with Poczta Polska S.A.:

- Process and Operations Function: developing processes and service support, developing a desired bank service and product offer and innovative functional and technological solutions essential for meeting business objectives, ensuring efficient supervision over performance of operational activities under agreements between the Bank and insourcers, developing, implementing and internal reporting of operating performance ratios, coordinating the Bank's capital investments, organizing an effective distribution channel for banking products and efficient client service through Contact Center, ensuring foreign currency transaction processing and settlements and settlement of transactions concluded by the Treasury Department.
- Department of Cooperation with Poczta Polska: carrying out the policy regarding consumer product sales and third-party products in the Poczta Polska network in compliance with the Bank's financial and market strategy and in cooperation with Poczta Polska.
- Logistics and Administration Department: ensuring appropriate work conditions and tools.

The functions are supervised by managing directors, which at the same time may manage individual organizational Head Office units included in a given function. Head Office organizational units report to managing, department or office directors. Head Office organizational units are included into functions and report to their managing directors, or operate beyond the functions and report to Management Board Members. Head Office organizational units are established, liquidated and assigned tasks in the form of resolutions passed by the Management Board in accordance with varying operational efficiency and management needs. The organizational units of the Head Office establish their own internal units (bureaus, teams, individual positions).

The Head Office includes committees whose operational rules are determined by the Management Board:

- Assets and Liabilities Committee (ALCO);
- Loan Committee (LC);
- Loan Appellation Committee (LAP);
- IT Initiatives Prioritization Committee (ITIPC);
- Operational Risk Committee (ORC);
- IT Architecture Committee (ITAC);
- Project Portfolio Management Committee (PPMC).

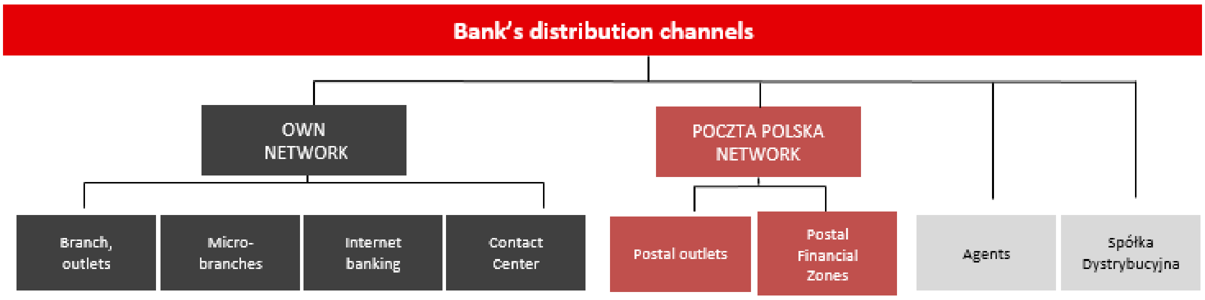
Bank's tasks as determined in its Charter are performed by the Branch and by the network of Outlets and Microbranches. A Branch is an organized unit recorded in the National Court Register and assigned a sort code. Its organizational rules are determined by the Management Board. Outlets and Microbranches are established and liquidated by means of Management Board's resolutions passed following a motion of the Business and Sales Function Managing Director, taking into account the need for the Bank to be efficient and to maximize sales performance.

10.2. Banking product distribution channels

Bank Pocztowy has a well-developed sales network consisting of:

- main channels, i.e. its own network, the Poczta Polska sales network and the distribution network of Spółka Dystrybucyjna;
- supporting channels: e-banking, Contact Center, agents.

Distribution channels' structure of the Bank has been presented below.



At the end of 2016 the Bank's own network included 217 entities, i.e. one Branch, 20 Outlets and 196 Microbranches. Following a series of analyses of effective location of the outlets and of their performance, in 2016 the total number of outlets was reduced by 67 entities, including the closing of three agencies located in trade malls. Most closed outlets had been located in the Silesian Region (11), in the Central Region (9) and in the Northern Region (9). The action steps aimed at improving the efficiency of the sales network will be continued in future and they may bring about relocation of certain outlets to locations with the higher business potential and further networks restructuring. The network revitalization complies with the new Bank Standards Book adopted by the Bank. In 2016 revitalization was performed in 13 Microbranches.

The network of traditional distribution channels in Bank Pocztowy by province:

31.12.2015

31.12.2016

Internet distribution channels are being developed as well. Consumers may use *Pocztowy24* e-banking system, while institutional clients have access to *Pocztowy24 Biznes*. Contact Center is a phone banking system, which enables clients to access their accounts and other banking services via phone or instant messengers. In 2016 the Contact Center employed 56 people. During the year, they answered 600,000 calls from customers, employees of Poczta Polska and Microbranches, replied to 75,000 e-mail messages and participated in 9,000 chats. Annual NPS generated by the Contact Center was 54.87%. Additionally, 86% customers confirmed that issues that made them contact the Bank were solved upon the first call. [13]

Additionally, the Bank's products are distributed by the net of Mobile Relationship Managers of Spółka Dystrybucyjna. Under the agency agreement with the Bank, Spółka Dystrybucyjna coordinates the work of mobile RMs, who sell mortgage products offered by the Bank, cash loans and products offered to microenterprises. The self-employed RMs operate countrywide. Under the agreement the RMs may use back-office units of Spółka Dystrybucyjna in ten locations: Warsaw, Gdańsk, Gdynia, Bydgoszcz, Olsztyn, Katowice, Łódź, Poznań, Krakowie and Wrocław. The RMs acquire new clients for the Bank using own business relations. At the end of 2016, Spółka Dystrybucyjna cooperated with 92 RMs.

The Bank provides financial services using the sales network of Poczta Polska (approx. 4.7 thousand offices including 570 Postal Financial Zones). Further, its products are distributed by postmen. The extensive network provides easy access to banking products and services countrywide.

Photos of outlets designed in line with the new standards have been presented below:

The scope of services provided by each channel distributing products and services of the Bank.

			Information and acquisition	Cash services	Retail customer service	Institutional customer service
Own network	Local offices and Branches	217				
	including Microbranches	196				
	Internet banking: Pocztowy 24, Pocztowy 24 Biznes	1				
	Contact Center - customer Service Bureau (helpline)	1				
	Contact Center - on-the-phone service at Spółka Dystrybucyjna (backup CC)	1				
Poczta Polska network	**Postal outlets** including:	4.7 thousand				
	- Postal Financial Zones	570				
	Postpersons	23 thousand				
Mobile advisers of Spółka Dystrybucyjna	Mobile advisers of Spółka Dystrybucyjna	92				
Local and network agents	Local and network agents	370				

13 *Net Promoter Score* (*NPS*) – a tool to evaluate customer loyalty, an alternative to traditional client satisfaction surveys.

10.3. Development projects

In 2016 the Bank incurred capital expenditure on development projects amounting to PLN 31.4 million, which was 39% higher than in 2015, when it equaled PLN 22.6 million. The increase in the capital expenditure in 2016 was to a large extent related to the Bank's plans to implement a new, extended mobile and online banking platform EnveloBank. Moreover, most investments pertained to IT and included the modernization and development of key IT components and optimization of back-office and sales processes. Some funds were used to develop security systems.
In 2016, investment outlays were mostly used to finance the following development projects:

Digital services development

- **EnveloBank**
  Commissioning of EnveloBank, the new digital brand of the Bank, responding to the needs of mobile customers, in 2017 is the key strategic projects. It has been the largest project carried out by the Bank in terms of its elements and the human and financial resources involved. In 2015 the Bank made certain efforts to prepare for the launch of the new brand, such as developing a technological solution, its implementation plan, product and service offer and adjusting processes to digital client service. The activities were continued in 2016, and the EnveloBank offer was extended beyond the scope of financial services. It will include products and services offered by other entities of the Poczta Polska Capital Group and by third parties.

Development of e-distribution channels

- **Instant transfers**
  Instant transfers, a new product in the Bank’s offer, have been implemented to drive the attractiveness of the Bank’s offer for mobile clients. Instant transfers enable clients holding current accounts with the Bank to make fast transfers within 20 minutes. Following the implementation in the second quarter of 2016, the Bank’s offer has been adjusted to market standards with respect to instant transfers.

IT and Operations

- **Front-End implementation in the offices of Poczta Polska S.A.**
  The project is a follow-up of the Front-End implementation in Bank’s Outlets and its key objective was to implement a new technological solution in the network of Poczta Polska S.A., which allowed extending the scope of products and services offered to clients through post offices, access to products and services in all postal outlets and improving the efficiency and speed of Bank’s product sales along with post-sales support of Bank’s customers. In 2015, Front-End (sales and post-sales support) was implemented in the Poczta Polska network, while in 2016 implementation of back-office processes modifications was completed.

Projects related to the Bank’s operations

- **Development of the Customer Relationship Management system**
  The key project objective has been to provide comprehensive CRM solutions which would integrate all communication channels and sales support systems, which allowed for developing mechanisms to collect client data and prepare special customized offer available in their preferred distribution channels. The offer is available through RM via CRM tool, in remote channels such as IVR and on the website through system integration in the project. Consequently, a strong relationship, beneficial for both parties, has been developed. All cross-selling initiatives encourage client activity and increase the number of products sold per one client at the same time increasing income in the consumer segment.
- **Modernizing the *workflow system* (Ferryt)**
  The project objective was to put into practice the following ideas:
  - “simple banking” achieved through simple user interfaces and short request processing time;
  - “@ccessible banking” achieved through new possibilities of filing requests for products and services.

  Additional objectives included optimizing processes, improved usefulness and system security.
  Full implementation of the upgraded version was completed in the first half of 2106.
- **Data Warehouse and MIS upgrade**

The Project objective is to provide business functions with timely, accessible and reliable information supporting performance of market and financial goals. The objective will be performed through the development of controlling methodologies, the upgrade and development of the Data Warehouse and Management Information System tools. Full implementation is planned for the second quarter of 2017.

- **Customer Lifecycle Management**
  The project focuses on Customer Lifecycle Management based on selecting most appropriate communication channels, communication and Bank credit products to the carefully selected client group.
  Development and implementation of the strategy in the first half of 2016 enabled precise alignment of the Bank's credit products with the needs of consumers. This, in turn, will drive cross selling and profitability.
- **New Cash Loan Approval Process**
  The project objective is to establish a single, simple and flexible process of selling cash loans to be extended by other or new products in future. The process is designed so as to become a flexible tool allowing adjustment of the credit offer to the needs and possibilities of clients, a transparent, fast and easy-to-handle process for Bank's employees. Its implementation is planned for the first quarter of 2017.

  The implementation will allow:
  - simplifying the cash loan application process;
  - increasing the number of cash loans sold by the Bank;
  - increasing revenue on cash loans and thus improving the related Bank's performance;
  - improving the loan portfolio quality.
- **Upgrade Risk.pro**
  The project included implementation of a new management system (along with an internal settlement model) underlying the calculation of capital requirements.
  The new version of Risk.Pro was implemented in the production environment in June 2016.
- **Extending Contact Center and Contact Center 24/7**
  The project assumed implementation of a solution that would allow further efficient operation of the Contact Center, its improved efficiency and productivity and introduction of new functionalities, which would enable providing services to a growing number of Bank's clients. Its going live planned in the first half of 2017 will allow extending the Call Center working hours to 24 h for seven days a week, which is the current market standards. This in turn will allow additional sales of cash loans or debit cards.
  The effects of the project include the Bank's winning the 5th place in the Remote Channel Client Service Quality Survey carried out the fifth consecutive time by MojeBankowanie.pl portal. The Bank saw the biggest advancement among all participants, improving its scoring by 19 p.p. versus the previous year. This implies an advancement from the 23rd place.

Additionally, the Bank implemented security projects involving extension of the IT security architecture (improving security through monitoring of remote access to the banking systems and to production environment) and implementation of a new anti-fraud and AML system limiting the risk of fraud detrimental to the Bank and enhancing anti-money laundering measures and terrorism financing prevention.

11. Human resources management

11.1. Headcount and employment structure

As at 31 December 2016, the Group had 1,546 FTEs vs. 1,618 FTEs at the end of 2015 (a decrease by 72 FTEs). The headcount was reduced in Microbranches following the optimization in the Bank's sales network and closing unprofitable outlets. Headcount in subsidiaries decreased by 22 FTE.
Employment in Head Office increased by 20 FTE, mostly in digital banking, in relation to implementation of EnveloBank planned for 2017.

FTEs	31.12.2011	31.12.2012	31.12.2013	31.12.2014	31.12.2015	31.12.2016	Change 2016/2015
Head Office of the Bank	788	712	727	669	685	705	20
Local offices and Branch	325	270	244	178	155	158	3
Microbranches	166	370	490	554	546	473	(73)
Subsidiaries	217	219	239	232	232	210	(22)
Total Capital Group	**1,496**	**1,571**	**1,700**	**1,633**	**1,618**	**1,546**	**(72)**

At the end of 2016, the Bank employed 1,345 people:

- most of the employees were female (946 FTEs, i.e. 71%);
- 5 years of service on average;
- the average age of an employee was 37.

An analysis of detailed employment data indicates that employee turnover reduction is a key development challenge, in particular in Microbranches and in IT. Comprehensive measures reducing the turnover ratio and improving incentive systems are planned for 2017.

11.2. Training and development

In 2016, development activities focused on supporting skills and knowledge necessary to effectively achieve goals and to ensure compliance with requirements of Bank's supervisors. Specialized training courses were delivered by external experts and internal resources.

Training courses improving business efficiency:

- Introductory training dedicated to new hires in the consumer segment, covering the Bank's product offer, professional sales techniques with final tests checking the knowledge of bank and investment products, systems and processing. The training is supplemented with internship supervised by an Expert and supported by a Trainer.
- Courses improving competences of Account Managers and Advisers with regard to winning new clients, work planning, goal-setting and monitoring, sharing knowledge and best practices, enhancing pro-sales attitudes and building long-term relations with clients.
- Training for retail network employees improving their prospecting and on-the-phone meeting arrangement skills.
- Courses improving work planning, goal-setting and supporting, efficient client winning methods, giving and receiving feedback, knowledge-sharing skills of Experts.
- Training courses advancing knowledge and skills related to investment funds. Delivered training included basic knowledge of investment products, MIFID, extending knowledge of POCZTOWY SFIO, sales conversation enhancement skills and knowledge of foreign and domestic markets.

The courses were supplemented with quarterly meetings of experts on investment products under the "Leader Club" initiative.

- Customer Relationship Management system training courses aimed at organizing knowledge and perfecting the ability to use the sales management system, initiated in 2015, were continued in 2016.
- Top salesmen could also develop their financial knowledge participating in the European Financial Advisor (EFA EFPA) studies. When participating in the studies, employees get introduced to the basic package of financial services, including investment and insurance products, learn simple application of maths in finance and analysis of key client's needs and profile. They understand the finance planning process, can match financial products to key client's needs and thus build their knowledge and competence base to take over the role of a trusted advisor in relations with their clients.
- A series of development measures was carried out to support Own Network Strategy implementation. Their scope included workshops for Regional Directors, Sales Support Managers and Experts. The related activities supporting the new working standards included preparation of movies and learning aids for e-learning purposes, regional on-the-job training workshops, managerial coaching and training, and a contest promoting work standards. Development activities included all sales employees.

Development programs:

- ROZWOJOWNIA (Development incubator)
  Internal expert knowledge sharing program Bank employees, experts in various fields, share their knowledge in the form of internal courses following appropriate preparation as trainers.
- DZIEŃ W MIKRO (A Day in Microbranch)
  The implementation program for new Head Office employees has been extended by one-day visit to Microbranch. The project objective is to gain a better understanding of the work in the sales network and products among head office staff and to foster cooperation between the sales force and the head office.
- WŁĄCZ ZIELONE (Turn on Green Light)
  A program supporting cooperation and communication between the Head Office and the sales network, aimed at managerial knowledge sharing. Head Office managers as mentors share their experience with sales network Experts.
- EFEKTYWNE CONTACT CENTER (Effective contact center)
  In 2016 development activities were performed to build managerial and trainer competences in the Contact Centre ('CC'). Workshops were held for managers and trainers on activities that build efficiency in a given area and a development program was delivered for CC trainers (Train the Trainer). A course for managers was delivered including introduction to contracting and executing targets, team incentives and selection of motivation tools.

Other training initiatives

- In 2016 the staff was offered individual support in the form of training, individual coaching, conferences, seminars and post-graduate studies focused on new consumer banking trends, finance, risk, security, internal audit and HR.
- Individual and group training courses for IT staff on project financing, programming languages, application development and databases and management of IT services.
- Obligatory training imposed by the law, e.g. by Labor Law, Banking Law, OHS, personal data protection.
- E-learning courses for Bank employees included security, banking secret, AML, personal data protection and ethics.
- A course for new hires entitled "Welcome to Pocztowy". It presents the mission, vision, strategy, values, processes and principles adopted by the Bank. The training also includes an introduction to IT systems and practical information useful in the first weeks of working at the Bank.
- Managerial workshops dedicated to managerial staff were aimed at working on the Bank's business strategy.
- "Train the Trainers" courses for Bank employees to prepare dedicated employees to carry out training in the sales network.

- E-learning courses for employees of Bank Pocztowy including security, bank secrecy, AML, personal data protection, ethics, quality standards, MIFID, CRM, as well as the Bank's product offer.
- In June 2016 an Employee Portal was launched in Intranet providing information, forms and documents regarding employee issues, as well as training and support materials: guides for new hires, and materials supporting quality conversations with employees.

Training for the Poczta Polska S.A. Capital Group
In 2016, e-learning courses for Poczta Polska staff initiated in 2015 were offered on product and systems (Ferry, Front End), security policy, and Front-End application in post offices.

In February 2016 implementation training was commenced for employees of Postal Finance Zones including banking products, pro-sales attitude and selling skills improvement. The training ended with an exam checking the knowledge of banking products.

Training for coordinators of the Poczta Polska sales network was carried out with regard to banking products and processes.

Courses at Centrum Operacyjne
Centrum Operacyjne has continued professional development of its employees and building its market position thanks to experienced staff.

In 2016, its employees participated in a number of training sessions and seminars:

Banking courses:

- document authenticity check, consumer bankruptcy, enforcement regarding a bank account in light of legal changes effective as of 8 September 2016, loan collateral;
- complaint handling and mediation in financial institutions; changes in deposit operations of banks.

IT and data security courses:

- CCNA, Introduction to Web Development with Microsoft Visual Studio 2010, internal control and IT supervision with respect to security.

Courses regarding recent law amendments:

- IAS, OHS, CCO, finance for non-bankers, HR and payroll, taxes, legal guide for managers, SAF-T.

On-the-job competence training:

- internal audit, Six Sigma – Black Belt, quality management, Excel and PowerPoint, process mapping, operating risk management, management accounting, real property valuation, project management.

The company obtained training funds from County Labor Office (from the National Training Fund). The program commenced in June 2016 and was to improve efficiency and productivity of employees with regard to banking, IT, processes and finance related knowledge. The funds from the National Training Fund were earmarked for training and post-graduate courses. Participation in the above courses brings measurable benefits to company employees since they can gain new skills and use them at work. Training participants improve their skills and thus become more innovative and self-reliant.

Another training program co-financed by the National Training Fund allows the Company to pursue a well-balanced training policy that improves its performance.

11.3. Incentive scheme

In 2011, the Bank implemented an incentive scheme based on the Management by Objectives methodology, where the variable portion of the remuneration depends of goal performance. Tasks and jobs and performance measures are determined depending on position and category: executives, direct sales support and support.

Attempts to link individual's remuneration with his/her performance and achievement of goals agreed on with the employee for a given period will allow the Bank to reinforce the variable portion of the remuneration to provide an additional incentive for work.

Additionally, focusing on key objectives allows mobilization and preparing the Bank for achieving stretch goals (including finance) in rapidly changing business environment. Implementing of MbO assumptions contributes to improving of productivity and competencies of employees, providing incentives and involvement in the performance of tasks aligned with strategic objectives.

Objectives for 2016 were determined based on:

- Bank's strategy,
- initiatives of Bank's business lines developed during managerial workshops,
- business initiatives commenced in 2015.

Recently, certain shortcomings have showed in the operation of the bonus system, related to the bonus calculation mechanism. Therefore, a material modification of the system is planned for 2017 so that the calculated bonus matches the performance of the Bank and of the Group.

Sales network employees are included in the commission-based remuneration system, which provides incentives to increase sales in selected product groups. Each product included in the sales plan has been assigned specific weight. Depending on the performance vs. plan, individual product weights affect the monthly commission amount.

The base pay system in the sales network is linked to the professional development path. It allows continuous professional development beginning from Junior Relationship Manager / Account Manager all the way through Relationship Manager / Account Manager and Senior Relationship Manager / Account Manager. Employees can be promoted every six months if specific criteria are met. Additionally, in each stage of the development path, they can improve their sales and product related qualifications through dedicated training. Promotion to a higher position entails a higher base pay.

11.4. Variable components of managerial staff remuneration

Implementing the requirements of PFSA Resolution no. 258/2011 of 4 October 2011 on detailed principles of operating risk management and internal control system, detailed terms of estimating internal capital in banks and review of the process of estimating and maintaining internal capital and determining the variable remuneration policy for managerial staff of banks, the Bank applies the variable pay policy for individuals on managerial positions. Following restrictions imposed by the Act on remunerating managers of certain entities of 3 March 2000, provisions regarding deferred variable compensation and non-cash compensation do not apply to the variable compensation of Bank's Management Board members.

The basis to grant an individual a variable compensation, including the deferred portion of such compensation, and to determine the total amount of the variable compensation applicable to qualifying individuals includes:

- assessing an individual's performance vs. individual goals planned for the year subject to evaluation,
- financial performance of the Bank for the last financial year,
- performance of the cost budget,
- financial profit/sales plan performance.

The variable compensation is deferred and at least 50% of its amount is paid in phantom stock entitling to cash receipt. The phantom stock value depends on its measurement as at the vesting date, based on equity per share amount adjusted by paid or payable dividend. The measurement is carried out and annually verified by the Bank's Finance Function based on annual consolidated profit of the Group, audited and approved by the General Meeting, within 15 days of the date of approval of the respective annual financial statements. In 2016, following a positive opinion issued by the Supervisory Board in the form of resolutions, the Bank paid the third deferred portion of variable compensation for 2012 of PLN 49.7 thousand. Variable compensation provisions regarding the deferral and non-cash compensation did not apply to the compensation for 2015. Therefore, the Bank did not defer the variable compensation for 2015.

12. Bank Pocztowy development strategy

12.1. Implementation status

As at 31 December 2016 "Development Strategy of Bank Pocztowy S.A. for 2015-2018" was the binding strategic document, approved by the Management Board on 16 April 2015.

The document updated the Bank development vision until 2018, thus responding to ongoing macroeconomic changes seen in the banking sector (reduced possibilities to pursue the former development model of a small universal bank) and assumptions arising from the strategy adopted by Poczta Polska S.A., as a result if which the importance of banking and insurance services in the Group's strategy increased.

Pursuant to these assumptions, the key characteristics that make the Bank stand out among competitors include:

- a network of offices which enable the widest access to financial products and services in Poland;
- a simple offer (one current account, three types of deposits: mini, midi and maxi and a simple cash loan), which satisfy basic financial needs of the Bank's clients;
- reasonable and competitive product prices;
- advanced integration with Poczta Polska, S.A. which consists in using its potential and developing the product offer in cooperation with other entities from the Poczta Polska Capital Group;
- simple and inexpensive sales and client service processes used in the Poczta Polska S.A. network;
- simple marketing communication in sales points and outlets of Poczta Polska;
- corporate culture focused on stretch goals.

The following strategic objectives to be achieved by 2018 have been defined in the Strategy:

- client base of PLN 2.4 million individuals;
- exceeding the balance of PLN 4 billion in consumer loans;
- credit portfolio diversification;
- reducing the total cost/income ratio to less than 60%.

In 2016, the Bank focused its operations on the following areas to achieve the strategic assumptions:

- EnveloBank, the new mobile and e-banking system
  Implementation of EnveloBank is a key element of the Bank's business model. It will provide response to the needs of the segment of young digital customers and ensure high acquisition level in mid-term perspective. At the same time, EnveloBank composes courier mail services with banking and insurance offer in the form of a modern user interface.
- Improving customer loyalty and satisfaction
  Measures undertaken in this area were supported by an extended CRM system and initiatives aimed at customer activation and improved cross-selling performance, mostly in the form of implementation of a new data warehouse linked to CRM.
- Improved customer service quality
  Implementation of new working standards for advisers and planned modification of incentive systems supporting employee loyalty and, thus, long-term relations with customers will improve the quality of customer service.
- Developing a low-cost operating model
  This goal will be achieved mostly through optimization of processes offering the largest improvement opportunities, as well as digitalization and automation of back office processes.

In 2016, changes in business environment and development perspective have contributed to the decision on development of a new Bank's Strategy. The key initiatives include:

- commencing works on a new Strategy of the Poczta Polska S.A. Capital Group;

- governmental projects and initiatives;
- growing competition on the financial services market;
- changes in distribution networks of banks;
- progressing digitalization of customers.

According to the work schedule agreed with the Supervisory Board, the new strategy shall be developed and approved in the first half of 2017.

12.2. Development directions for 2017

Key activities carried out in 2017 which should contribute to performance of key strategic objectives include:

- digital bank launch in 2017 (EnveloBank project). The initiative is aimed at encouraging young people to use services of Bank Pocztowy. Project details have been presented item 12.3 hereof;
- sustainable growth in sales of consumer loans based on a new, modernized loan process, at the same time ensuring loan portfolio quality improvement;
- extending the scope of key transaction-related services offered to customers ensuring transparency and accessibility of offered products;
- continuing White Label sales of investment funds under Bank's brand;
- developing a custom-made attractive offer for microenterprises and a financing program for that segment using domestic and EU funds;
- developing clearing services with special focus on money transfers dedicated to immigrants;
- continuing works on the implementation of the Customer Relationship Management system, which allows for increasing sales margin;
- continuing rebranding of traditional outlets, at the same time increasing activity in Microbranches.

Key business objectives for 2017:

- increase in the balance of consumer loans and in loan portfolio profitability;
- improved profitability of current accounts;
- a one-third increase of the balance of net current assets in the funds;
- maintaining the existing performance in the institutional segment;
- improving loan portfolio quality.

Further, the Bank will try to obtain some capital injections, mainly in order to meet regulatory requirements regarding capital adequacy measures.

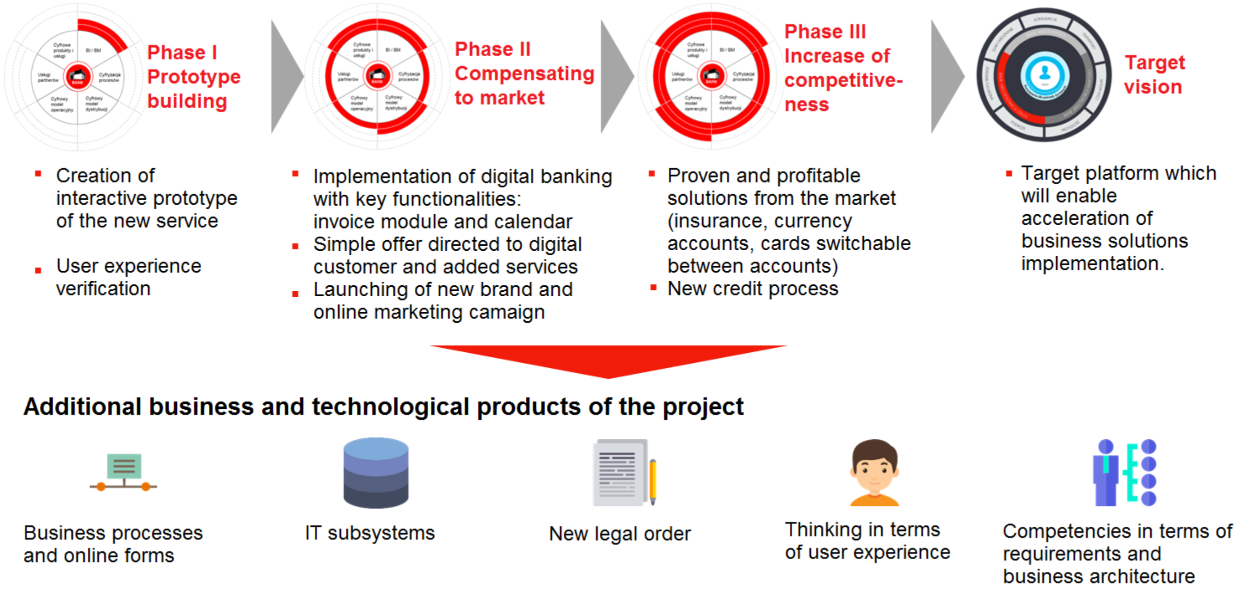
The Group's ability to achieve the objectives determined for 2017 shall depend mostly on external conditions, in particular the economic growth seen in Poland and decisions regarding interest rates made by the Monetary Policy Council. Material factors that may reduce projected profit include: growing amortization costs related to implementation of the mobile banking system, increased charges paid to Bank Guarantee Fund and the banking tax.

12.3. EnveloBank: a new digital brand

Key strategic projects pursued in 2016 and 2017 include the commissioning of EnveloBank platform, a new digital brand responding to the needs of digital customers the Bank has increasingly focused on. EnveloBank is an initiative included in the idea of digital development of the Poczta Polska S.A. Capital Group.

The project is nearing the Stage 2 closing, which will result in making the EnveloBank solutions accessible to customers in 2017.

At present, the solution is being tested.



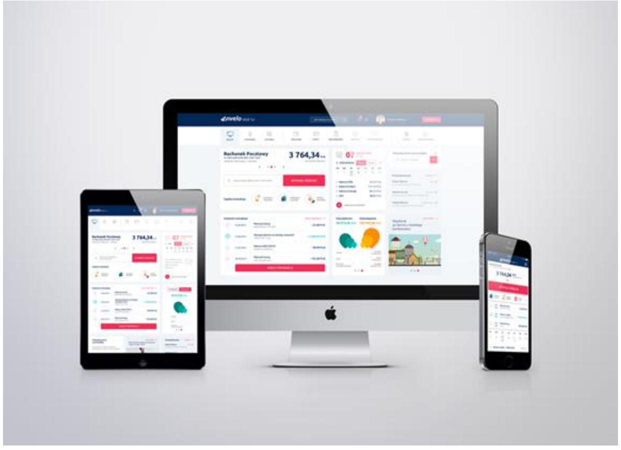
Subsequent stages will include its adjustment to customer expectations based on experience gained in the course of cooperation with customers.

The new offer shall combine banking and postal services offered by the Group with those offered by external partners.

Target EnveloBank ecosystem

Building added value through synergy in offering both existing and new products to digital clients in the Poczta Polska S.A. Capital Group companies is of key importance for the project.

The designed solution shall be available in the form of RWD-based banking interface and a dedicated mobile application for IOS and Android.



EnveloBank offers useful functionalities and is user-friendly as its design includes user experience (UX). The user interface and EnveloBank application have been tested in the course of comprehensive focus and expert survey, which has resulted in implementation of over 100 recommendations that will improve end-user experience.

The key objective of the EnveloBank project is to improve competitiveness of the Bank's offer and entering the rapidly growing digital consumer market.

In the coming years, EnveloBank shall become an important tool attracting new customers and thus shall significantly impact the speed and quality of Bank's business development.

13. The Bank in the society

Corporate social responsibility of the Bank towards its clients, employees, shareholders, bondholders and the society is an integral part of its operations. The principle has been confirmed in the new development strategy for the years 2015-2018 adopted in April 2015.

The mission of the Bank is to be a leading supplier of financial services in provincial Poland, offering simple, secure and reasonably priced banking.

Bank Pocztowy: what is it like?

- Simple. Focused on simple products.
- Inexpensive. Offering good prices for a wide group of clients.
- Integrated with Poczta Polska S.A. and offering modern services within the Poczta Polska S.A. Capital Group.

13.1. Relations with clients

The main objective of all activities taken by Bank Pocztowy is to constantly improve client satisfaction by way of offering products and service responding to their needs.

Simple, secure banking for a reasonable price is the mission of the Bank, the starting point to simplify its product offer, processes, procedures and communications. The strategy assumes a simple offer available in the vast sales network of Poczta Polska targeted at mass clients from towns of below 50 thousand inhabitants. The Bank decided to develop a mobile offer for digital clients integrated with services of the Poczta Polska Capital Group (including consumers and microenterprises) and to continue growth in the housing and settlement areas.

Having in mind client needs in 2016 the Bank introduced a number of innovative initiatives aimed at improving service quality and higher client satisfaction with the Bank's services. They included projects discussed in more detail in the Report, such as: streamlining a number of the Bank's Contact Center areas, simplifying the product offer, developing a new website www.pocztowy.pl and an educational website on stock exchange giełdowy.pocztowy.pl, as well as preparing a top-quality interactive on-line annual report.

The Bank incessantly strives to further improve the customer service quality taking appropriate steps in the following areas:

- training Relationship Managers,
- monitoring service quality,
- client satisfaction surveys Net Promotor Score (NPS).

The Bank focuses on natural communication and starting friendly relationships with clients, hence it no longer encourages traditional standard sales communication. Service standards need constant adjusting to needs and expectations of the target client group.

In order to ensure high service quality, we have adopted client service standards depicting desirable behavior to be adopted by advisers when discussing with clients. The description includes discussing with clients coming to the outlets, telephone calls and e-mail correspondence. The aspects described in the book of standards are monitored in the form of Mystery Shopping and Mystery Calling.

Also, a blog has been maintained on the Bank's website as an element of dialog with clients. A number of messages published in the blog, such as introducing *Pocztowy24*, the new Internet banking system, have met a strong response on the clients' side.

The Bank has used its Facebook profile and YouTube to reach its clients, too.

In 2016, in the Customer Satisfaction Survey carried out by ARC Rynek i Opinia, which included the 15 largest banks in Poland, Bank Pocztowy won recognition in three categories:

- 2nd place in the satisfaction ranking,
- 3rd place in the loyalty ranking,
- 1st place in the fee and commission ranking.

Further, Bank Pocztowy won the prestigious title of "Bank Recognized by Clients". Key conclusions of the survey included a statement that "Bank Pocztowy has retained a high position in the satisfaction ranking, which confirms that it has a group of dedicated clients and knows how to satisfy their needs".

13.2. Relations with employees

Implementation of the Bank's strategy would not be possible without mature managers and devoted employees.

Social responsibility regarding relations with Bank's employees involves:

- providing employees with promotion and development opportunities,
- succession plan implementation,
- providing friendly and safe job positions,
- integrating and enhancing bonds with the employer,
- improving internal communication,
- ensuring ethical management,
- ensuring work-life balance, among others through supporting employees' passions and hobbies.

An employee involvement survey carried out in 2015 indicated a relatively low involvement of Bank's employees. Therefore, measures were undertaken to prepare a complex plan aimed at significant and permanent improvement. At the same time, cooperation with the Social Partner and work-life balance supporting activities are coming into focus.

Various aspects of remuneration policy, competency building, developing growth and promotion paths are presented in Section 10 Human resources management.

The Bank supports non-professional interests of its employees, to include sports. Most sports events are organized in cooperation with Poczta Polska.

In 2016, the calendar of events included 30 initiatives, out of which four were sponsored by the Bank and two organized directly by it. Employees of the Bank participated in the following sports events:

- Indoor Football Championship for Poczta Polska S.A. Employees in Iława (six-member teams),
- International Sailing Championship of Poczta Polska S.A. in Giżycko,
- Poczta Polska S.A. Olympics in Sieraków near Poznań,
- Shooting contest in Ustka, during which the Amber Globe Competition was held (both events organized by the Bank),
- InO Competition in Zawiercie (organized by the Bank),
- Postal Courier Run and Warsaw 10 km Run.

Almost 250 employees of the Bank participated in these events. Moreover, almost 50 persons received a grant for their participation in mass events, mainly in street runs organized by various organizations in Polish cities.

The employee relationship policy is supported by activities initiated under Social Benefit Fund. In 2016, the Fund:

- provided non-refundable support to individuals affected by accidents or facing material, family or other serious life problems,
- co-funded organized vacation for children and youth aged up to 18 and purchase of school books,
- co-funded group benefits, so-called open cultural, educational and sports events,

- co-funded MultiSport initiative,
- provided seasonal benefits for employees' children (Christmas, Easter) and cash benefits for all employees of the Bank. The gift giving event organized on 6th of December enjoyed popularity among employees,
- provided employees assistance in the form of reimbursable housing loans.

13.3. Social initiatives

For years, the Bank has pursued initiatives that produce benefits in the form of broadened knowledge of finance and banking among citizens (education) and social inclusion (e.g. donations).

Such initiatives, exceeding the standard business operations and understood as the social mission of the Bank, are usually addressed to children, youth or elderly people in need of special care.

In 2016 the Bank got involved in the project named Bakcyl - Bankowcy dla Edukacji Finansowej Młodzieży (Bankers for Financial Education of the Youth). The project is an example of socially responsible initiative, improving the understanding of finance among young Poles, and based on voluntary involvement of bank employees as trainers. Non-banking firms and institutions are also invited. This year, Bank employees acted as teachers in gymnasiums, introducing students to finance and indicating advantages of such knowledge, to include smart household business management.

The Bank participated in the World Youth Day organized in Poland in 2016, supporting the organization of the Culture Zone in Warsaw. The Zone offered sport and charity events addressed to the youth and animations demonstrating and promoting Polish culture.

The social mission of the Bank included also providing educational aids (computers, laptops) to selected education centers.

Bank's employees get involved in other voluntary initiatives, such as the Noble Box.

Understanding the growing role of new technologies in business and everyday life, the Bank is interested in new, innovative solutions. Therefore, it got involved in impact'16 fintech/insurtech conference and became its Partner. The conference took place on 7 and 8 December 2016 and attracted nearly 500 participants, 100 domestic and foreign speakers, resulting in 250 meetings of startups and corporations. Discussed topics included new regulations on the financial market, blockchain and cryptocurrencies, cyber security, information management, new payment models and education in the banking sector.

13.4. Supporting business

Entrepreneurship is a characteristics that allows many people to improve their lives. The most industrious ones open new businesses which bring benefits to the society, significantly supporting Polish economy, providing new jobs and promoting growth of local communities. Promoting such attitudes is an objective of the Bank.

Therefore, in 2016, the third consecutive time, the Bank partnered the Business e-Gazelles ranking, which recognizes the most energetic SME operating on the e-commerce market in Poland. During this edition, 333 winners were appointed for sales revenue growth in 2014-2015 (up to PLN 100 million) and a profit generated in 2015.

Promoting entrepreneurship includes organization of events, lectures, courses or scientific conferences that popularize pro-active attitudes. A training seminar entitled "Fair ways to make money" organized by the Management Faculty of University of Łódź in cooperation with the Bank had a similar objective. It promoted business ethics and values and attracted managers and young people interested in production, sales, services and, at the same time, value and brand building, mission and organizational strategy, as well as in personal growth.

Further, the Bank got involved in the organization of "Innovative woman" congress held in November 2016 in Zawiercie. The event promoted female entrepreneurship and was devoted to innovation, growth, development, benefits and new ideas. Its guests represented the following sectors: power, finance, trade, PR, fashion, arts, media, legal, entertainment, HR, science, production, cosmetics, consulting, health care, steel, mining and public administration.

13.5. Promoting sports

For still another year, initiatives of the Bank promoted sport, which is an important activity for many Poles.

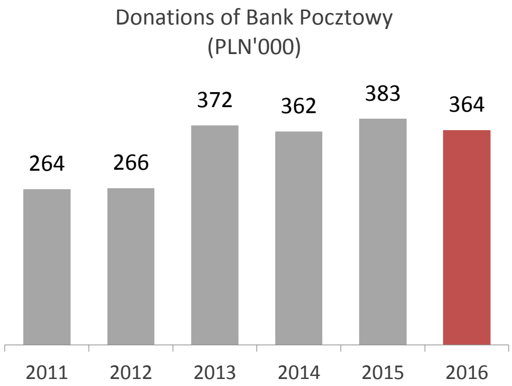
Its involvement allowed Stal Gorzów Wielkopolski motorcycle team to organize the Championship of Poland speedway contest in summer 2016. The fact that Stal Gorzów Wielkopolski team won the title the ninth time in history makes the event even more satisfying.

13.6. Donation policy

The Bank has a Donation Committee, which, according to the Charter, may distribute up to 1.5% of gross profit generated in the previous financial year.

Funds provided in this manner are used for a variety of noble purposes, such as education, support for those in need (often socially excluded) due to handicaps or adverse circumstances.

In 2016, donations granted by the Bank amounted to PLN 364 thousand.



13.7. Social package

Like in the previous years, in 2016 Bank Pocztowy provided its employees with a large package of additional benefits. At the same time, it started works to make them more attractive, by way of adding new benefits, taking into account staff preferences:

- comprehensive medical care providing employees with broad access to private medical services, with an option to extend it to their family members on preferential terms. The package was additionally extended by new medical services access standards.
- Sports and entertainment: The Bank continued its cooperation with Benefit Systems Sp. z o.o. Thanks to MultiSport cards all employees are granted unlimited access to sports and leisure facilities around the country. Further, each employee can buy additional cards for children and partners on preferential terms, under an agreement concluded between the Bank and Benefit Systems Sp. z o.o.
- Employee Pension Plan (EPP) significantly contributing to safe financial future of employees due to the growing need to accumulate capital for future pension benefits.
- Voluntary group life insurance: under the agreement between the Bank and the selected insurance company employees may buy life insurance on advantageous terms.
- Social benefits: employees may use benefits offered by the Social Benefits Fund established pursuant to the Act on Social Benefits Fund of 4 March 1994 (as amended) and the Social Benefits Fund Operational Rules of Bank Pocztowy S.A. Each eligible person may use the Fund in the form of:
  - participation in various forms of sport and cultural events organized by the Bank,
  - receiving financial support in challenging and unpredictable situations in life.

  Such support is provided based on social criteria in the following forms:
    - non-refundable financial or non-financial support,
    - subsidized textbooks for employees’ children who are still at school,
    - subsidized holiday travel for children and teenagers,
    - refundable loan for housing purposes.

In 2016, appropriation to the Social Benefits Fund amounted to PLN 2.2 million.

14. Corporate governance and management

14.1. Corporate governance principles and application scope

7 General Shareholders' Meetings	7 Meetings of the Supervisory Board	55 Meetings of the Management Board
In 2016	In 2016	In 2016

Corporate governance principles for supervised institutions

On 22 July 2014, the Polish Financial Supervisory Authority (PFSA) adopted Corporate governance principles for supervised institutions, expecting their implementation as of 1 January 2015. Beginning from 2015, application of the principles will be included in supervisory review and assessment (BION) and regularly reviewed. The purpose of the principles is to improve corporate governance standards and transparency of operation of institutions supervised by PFSA.

Corporate governance principles issued by PFSA defined internal and external relationships of the supervised institutions, to include relations with shareholders and clients, organization, internal supervision and key internal systems and functions, as well as statutory bodies and their cooperation.

PFSA decided that the corporate governance principles should be adopted by the supervised institutions (banks), become a crucial program paper underlying their strategic corporate policy and form appropriate procedures and proceedings in these institutions.

Therefore, on 22 December 2014, Extraordinary Shareholders' Meeting of the Bank approved "Corporate governance principles for Bank Pocztowy S.A." (the "Principles") determining internal and external relationships of the Bank, including those with shareholders and clients. Further, the Principles regulate the operation of internal supervision, key internal systems and functions, as well as statutory bodies and their cooperation.

The Corporate governance principles for supervised institutions issued by PFSA state that the supervised institution should apply the principles determined therein to the widest extent possible, including the principle of proportionality arising from the scale of operations, business specifics and nature of each institution. Refraining from the full application of specific principles is allowed only if their comprehensive implementation would be impractical for the supervised institution.

The Principles introduce the following principles adjusted to the specifics of the Bank:

- Article 8.4 "If justified with the number of shareholders, the Bank shall attempt to help them participate in General Shareholders' Meetings, among others allowing active participation through the Internet."
- Article 21.2: "Supervisory Board includes the position of Chairman, who manages its work. The Chairman is appointed based on experience and team leadership skills".
- Article 29.1: "Subject to relevant legal regulations, remuneration of Supervisory Board members is calculated adequately to their roles and to the scale of Bank's operations. Members appointed to work in committees, including the Audit Committee, should be paid adequately to the additional tasks they perform in these committees."

The Bank does not apply principles referred to in section 9 "Exercise of titles arising from assets purchased at client's risk" since principles determined in Articles 53-57 do not apply to the Bank, since it does not perform services involving asset management at client's risk.

As expected by PFSA, the Principles have been adopted as of 1 January 2015.

Pursuant to Article 27 thereof, the Supervisory Board shall evaluate implementation of the principles introduced thereby on a periodic basis, and the results of the evaluation shall be published on Bank's website and communicated to the other bodies of the Bank.

The Bank's Charter assumes annual evaluation of the Principles.

For alignment purposes, other corporate documents have been adjusted: the Bank's Charter, Operating Rules of the Supervisory Board, and Operating Rules of the Management Board; besides, Operating Rules of the General Shareholders' Meeting of Bank Pocztowy S.A. were adopted.

Application of the Principles took form of both amendments to internal regulations and activities undertaken by the Bank and its bodies with regard to organization and organizational structure, relations with Shareholders, compensation policy, information policy, promotion and client relations, as well as key systems and internal functions.

In Resolution no. XIV/20/X/2016 of 31 August 2016, regarding evaluation of the application of Corporate Governance Principles for Bank Pocztowy S.A. in 2015, the Supervisory Board approved the application of the Principles by the Bank in 2015.

The report evaluating application of the Principles in 2015 was distributed to other Bank's bodies and disclosed on the website.

On 16 September 2016 Extraordinary Shareholders' Meeting of the Bank acknowledged the Report evaluating application of Corporate Governance Principles for Bank Pocztowy S.A. in 2015 as proposed by the Supervisory Board.

Ethics in the Bank

On 11 June 2013, Bank Pocztowy implemented the Banking Code of Ethics (the "Code") adopted by Polish Bank Association. The document, accepted by the General Shareholders' Meeting of Polish Bank Association on 18 April 2013 is a set of good banking practices regarding banks themselves, their employees and agents.

According to the *Code,* banks, as public trust institutions, shall respect legal regulations regarding their operations, recommendations of PFSA, resolutions of the banking self-government, standards included in the Code and good commercial practices. Banks, their employees and agents follow the principles of professionalism, reliability, objectivity, due diligence and best knowledge. Carrying their business operations, banks should contribute to social and economic domestic growth and increase in social wellbeing through respecting CRS principles, innovative solutions and support of educational initiatives. Social responsibility is the fundamental principle underlying relations of banks and their employees with environment. When following their business strategy, banks should consider both economic conditions and legitimate interests of their clients, employees, shareholders, business partners and local communities. The Code includes principles of the Financial Market's Code of Best Practices.

In August 2014, the Bank adopted an internal document entitled *Code of Ethics for Employees of Bank Pocztowy S.A.* The document describes key aspects of banking ethics, in particular relations with clients, employees, local environment, handling of complaints, avoidance of conflict of interests, non-competition clauses, transparency of purchase processes and informing about irregularities. The above aspects are regulated in details by separate internal principles and procedures.

Compliance Department of the Bank provides training on ethics both in the form of classroom courses and e-learning, also, it carries out regular surveys (questionnaires) of understanding of internal regulations on ethics and appropriate behavior of employees if put in a potentially unethical situation.

In 2016 the Bank amended its *Whistleblowing Principles*. Employees may use a variety of whistleblowing channels and manners, from informing direct supervisors all the way through a dedicated phone number and e-mail address and direct contact with a Management Board Member. All notifications are given proper attention, analyzed and solved.

Code of Best Practice for WSE Listed Companies

Since Bank's securities are not traded on the regulated market (its bonds are listed with *Catalyst*, the over-the-counter trading system), it is not bound to follow the Code of Best Practice for WSE Listed Companies.

In 2016 the Bank followed principles included in the Code of Best Practice for WSE Listed Companies to the extent applicable to non-public companies. When preparing for IPO, on 24 April 2012 the Management Board passed a resolution to apply the Code of Best Practice for WSE Listed Companies. In the resolution, it declared the will to follow the principles and recommendation of the Code as of the date of approving the prospectus, except for principle IV.10 and recommendation I.5, I.9, I.11 and I.12. In the justification of the resolution, the Management Board provided a detailed explanation (technical reasons regarding principle IV.10 and formal reasons regarding the other) why the above principles and recommendations should not be followed.

14.2. Control in the course of preparing financial statements

Internal control in the Bank

The Bank has an internal control system adjusted to the risk nature and profile, as well as to the Bank's operation scale. The Supervisory Board supervises implementation of the internal control system, while the Management Board designs it, implements and ensures its efficient operation.

The internal control system is embedded in the management system. The purpose of the internal control system is to support decision making processes that contribute to efficiency and effectiveness of the Bank's operations, reliability of financial reporting and compliance with external and internal regulations.

The internal control system includes risk controls, compliance check and internal audit. Along from the institutional control performed by internal audit, functional control performed on all organizational levels by each employee with regard to quality and correctness of performed activities and by managers as an element of their supervisory duties constitutes the other element of the control system.

Detailed principles of operating the internal control system are determined by internal regulations of the Bank. The internal control system includes all processes performed in the Bank, including the preparation of financial statements.

The internal control of financial statements takes place:

- at the stage of developing internal regulations that depict processes performed in the course of Bank's operations – their compliance with accounting regulations – in particular with International Financial Reporting Standards as endorsed by the European Union and the Accounting Act. Internal regulations on accounting are verified on a regular basis for compliance,
- at the stage of routine operations, where postings in the Bank's books are verified in accordance with functional control principles,
- in organizational units independent from those carrying out operations, where postings in the books are checked for compliance with internal procedures regarding management of the general ledger,
- at the data generation stage through algorithms validating data in IT systems that support the preparation of financial statements,
- in organizational units preparing financial statements through verification of consistency and integrity of the presented data.

14.3. Entity authorized to audit financial statements

The entity authorized to audit or review financial statements is appointed by the Supervisory Board upon recommendation of the Audit Committee.

On 26 March 2015, the Supervisory Board, acting pursuant to Article 12.2.8 of the Charter and Article 3.1.24 of the Operating Rules of the Supervisory Board appointed Deloitte Polska Sp. z o.o. Sp. k. a certified auditor to audit the financial statements of the Bank and of the Capital Group for the years 2015-2016.

Gross fee of the entity authorized to audit financial statements (PLN'000)	2016	2015
Statutory audit of the financial statements	280	280
Review of mid-year financial statements	96	96
Other services*	223	1,641
Total	**599**	**2,017**

** Including costs of preparing the Prospectus of the Bank*

14.4. Shareholding structure and share capital

As at 31 December 2016, the Bank's share capital amounted to PLN 110,132,880 and was composed of 11,013,288 shares with a face value of PLN 10 each. The Bank's shares were fully paid up.

	Number of shares	Registered in	Value of shares (PLN'000)
Registered shares, A series/face value of PLN 10 each	291,300	2011	2,913
Registered shares, B series/face value of PLN 10 each	9,437,740	2011	94,377
Registered shares, C1 series/face value of PLN 10 each	1,284,248	2015	12,843
Total	**11,013,288**		**110,133**

General description of shares:

- 291,300 registered A series shares (held by Poczta Polska S.A.) carrying no preference;
- 7,005,470 registered B series shares (held by Poczta Polska S.A.) and 2,432,270 registered B series shares (held by Powszechna Kasa Oszczędności Bank Polski S.A.) carrying no preference;
- 963,186 registered C1 series shares (held by Poczta Polska S.A.) and 321,062 registered C1 series shares (held by Powszechna Kasa Oszczędności Bank Polski S.A.) carrying no preference.

Each ordinary share gives its holder a title to dividend and one vote at General Shareholders' Meeting.

In 2016, the share capital of the Bank and its shareholding structure did not change.

Shareholder	Number of shares	Number of votes	Face value of shares (PLN)	Interest in the share capital
Poczta Polska S.A.	8,259,956	8,259,956	10	74.9999%
Powszechna Kasa Oszczędności Bank Polski S.A.	2,753,332	2,753,332	10	25.0001%
Total	**11,013,288**	**11,013,288**		**100%**

Poczta Polska S.A. is its majority shareholder (75% less ten shares) and PKO Bank Polski S.A. is its minority shareholder (25% plus ten shares).

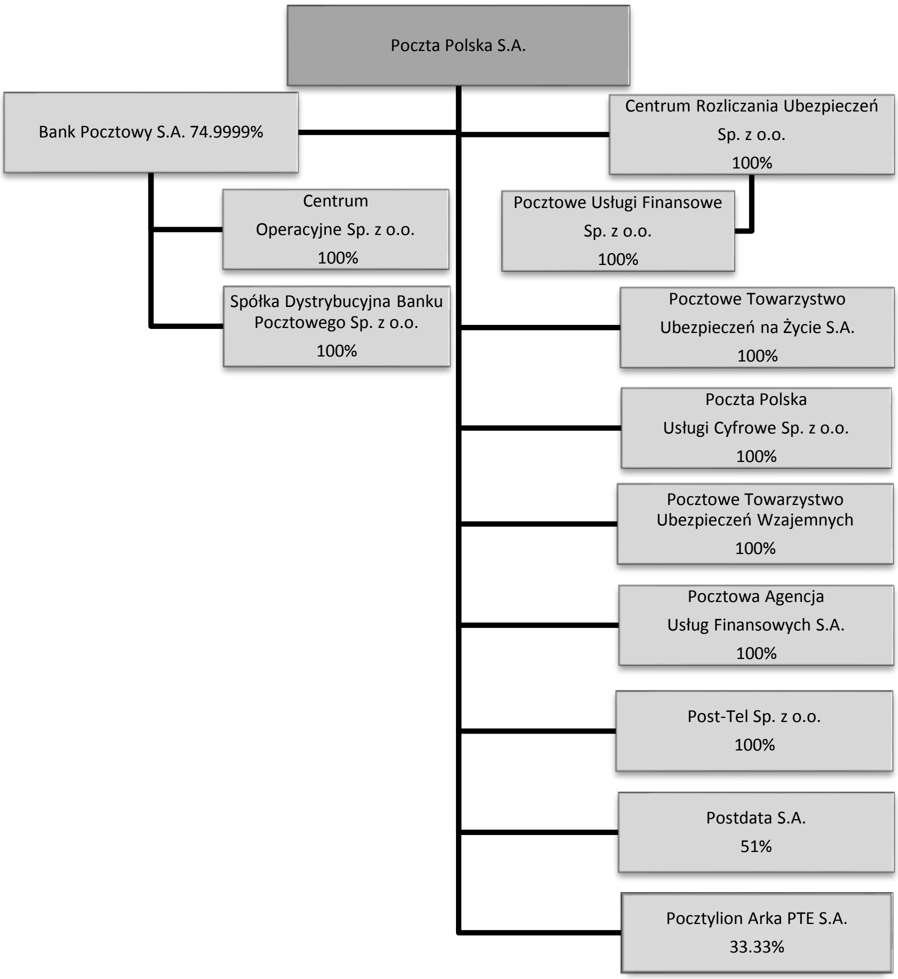
14.5. General information about Poczta Polska S.A., the majority shareholder of the Bank

Poczta Polska is a firm with 455 years of tradition, providing services to consumers and businesses. It provides postal services (letters, packages), banking and insurance services (through Capital Group companies) and logistic services. Further, it develops digital services (neo-stamp, neo-letter, neo-postcard) performed through an Internet platform.

Poczta Polska is one of the largest Polish enterprises in terms of the distribution network (the total of over 7.4 thousand offices of various kind as at 31 December 2016), including over 4.7 thousand outlets distributing bank and insurance products. Thanks to its extensive network and a wide services scope Poczta Polska can reach nearly every Pole. Moreover, having won the tender Poczta Polska will act as a universal service provider of postal services from 1 January 2016 to the end of 2025 under the decision of the Office of Electronic Communication. Therefore, it will operate a great number of distribution outlets countrywide, as required by applicable regulations.

The Poczta Polska S.A. Capital Group includes Poczta Polska S.A. and Bank Pocztowy, Pocztowe Towarzystwo Ubezpieczeń Wzajemnych, Pocztowe Towarzystwo Ubezpieczeń na Życie S.A., Poczta Polska Usługi Cyfrowe Sp. z o.o., Pocztylion – Arka PTE S.A, POSTDATA S.A., Pocztowa Agencja Usług Finansowych S.A., POST-TEL Sp. z o.o., Pocztowe Usługi Finansowe Sp. z o.o. and Centrum Rozliczania Ubezpieczeń Sp. z o.o.

Below please find the structure of the Poczta Polska S.A. Capital Group and the interest held by Poczta Polska S.A. in the Bank's share capital and voting rights as at 31 December 2016.



The Bank operates and pursues its strategy based on resources and infrastructure of Poczta Polska, hence gaining access to a wide group of clients, in particular in provincial Poland. Based on agreements concluded with Poczta Polska S.A., the Bank has been using approx. 4.7 thousand postal outlets including 570 Postal Finance Zones operated by specialized employees of Poczta Polska S.A., dedicated solely to sell and provide financial services and approx. 23 thousand postpersons.

Poczta Polska S.A. is wholly owned by State Treasury and supervised by the Ministry of Infrastructure and Construction.

More information regarding Poczta Polska and its financial performance is provided on its website http://www.poczta-polska.pl/o-firmie/.

14.6. Cooperation with Poczta Polska S.A.

The Bank carries out strategic partnership with Poczta Polska based on a plan determining its key objectives and how to achieve them.

Under the strategic partnership, the Bank is entrusted with a material role in implementation of the financial services strategy in the Poczta Polska S.A. Capital Group. At present, sales of financial products have been performed through two separate channels: Poczta Polska outlets and own outlets of the Bank. Organizational changes introduced in Poczta Polska and in the Bank are to implement the optimized solution for sales of financial services using a single postal sales channel consisting of a network of cooperating outlets of Poczta Polska and of the Bank.

The Bank has been provided a unique opportunity to use the network of Poczta Polska S.A. outlets. Since the Bank's own network is mostly located within the infrastructure of Poczta Polska, its extension does not require high capital expenditure. Capital expenditure for greenfield outlets (without access to Poczta Polska infrastructure and network) would be much higher than when developing a network based on existing post offices.

Thanks to access to Poczta Polska S.A. outlets countrywide, also in small towns and villages, where no competition of other banks exists, the Bank has successfully acquired clients from its target segments. With regard to development of financial services, strategic plans assume further improvement of sales efficiency of Postal Financial Zones with business ratios close to the levels achieved in Bank's own outlets.

The sales of Bank's products and services are based on an agency agreement. According to the agreement, Poczta Polska S.A. outlets sell current accounts, corporate and saving accounts, term deposits, cash loans for consumers, credit facilities for microenterprises, credit cards and the related services. Access to the network of sales outlets and postal infrastructure allows the Bank to offer institutional clients with services including payment orders (among others using Money Gram), over-the-counter and sealed cash deposits and cash processing services.

Further, Poczta Polska is the Bank's client provided with comprehensive financial services. Including cash payments accepted in Poczta Polska network addressed to a variety of counterparties, to include Social Insurance Institution and tax offices (transfer funds) and cash receipts from Poczta Polska network to third parties indicated by Bank's clients into interbank settlements is a significant source of commission income generated by the Bank.

Cooperation of the Bank and Poczta Polska is regulated by a series of arrangements addressing its key aspects. They have been concluded on arm's length terms for an indefinite period.

14.7. Investor relations

Since December 2011, Bank's bonds are traded on the Over-The-Counter market of the Warsaw Stock Exchange (*Catalyst*).

The key purpose of investor relations is to provide the stakeholders with up-to-date and reliable information regarding the Bank in a simple and clear manner, in compliance with the law.

Since Bank's shares are not traded on a regulated market, in 2016 its investor relation activities focused mostly on information obligations arising from the fact that the Bank's shares are quoted with the Alternative Trading System on the *Catalyst* market operated by Warsaw Stock Exchange (*ASO GPW*).

Since 3 July 2016 the Bank, as an issuer of securities traded in an alternative trading system, is obliged to follow the Regulation of the European Parliament and the Council (EU) no. 596/2014 of 16 April 2014 on market abuse ("MAR Regulation"). The regulation has replaced relevant Polish regulations implementing Directive 2003/6/EC of the European Parliament and the Council of 28 January 2003 on insider dealing and market manipulation.

At the end of 2016, the following bonds of the Bank were quoted with *ASO GPW* (*Catalyst*):

Series	Type	Number in ATS of WSE	Number in National Deposit for Securities	Issue date	First quotation	Redemption date	Face value (PLN)	Number of bonds	Issue value (PLN)	Interest rate
P1	subordinated	BPO80626	PLPBCZT00080	01.09.16	08.09.16	08.06.26	100	500,000	50,000,000	WIBOR 6M+2.80 p.p.
C	subordinated	BPO1022	PLBPCZT00031	05.10.12	20.02.13	05.10.22	10,000	5,000	50,000,000	WIBOR6M+350 b.p.

At the end of 2015, the following bonds of the Bank were quoted with *ASO GPW* (*Catalyst*):

Series	Type	Number in ATS of WSE	Number in National Deposit for Securities	Issue date	First quotation	Redemption date	Face value (PLN)	Number of bonds	Issue value (PLN)	Interest rate
A	subordinated	BPO0721	PLBPCZT00015	08.07.11	02.12.11	08.07.21	10,000	4,734	47,340,000	WIBOR6M+375 b.p.*
B2	ordinary	BPO1216	PLBPCZT00049	13.12.13	13.03.14	13.12.16	10,000	14,785	147,850,000	WIBOR6M+140 b.p.
C	subordinated	BPO1022	PLBPCZT00031	05.10.12	20.02.13	05.10.22	10,000	5,000	50,000,000	WIBOR6M+350 b.p.

** Until 8.07.16; from 9.07.16 to 8.07.21 WIBOR6M+3.75+1.5 p.p.*

In 2016, the following changes occurred with regard to bonds quoted with Catalyst:

- On 8 July 2016 the Bank prematurely redeemed 4,734 subordinated bearer bonds with the total face value of PLN 47,340 thousand, assigned the code PLBPCZT00015 by National Deposit of Securities and quoted in the Catalyst alternative trading system operated by Warsaw Stock Exchange under the abbreviated name BPO0721.
- In Resolution no. 588/16 of 30 August 2016, the Management Board of National Deposit of Securities (KDPW S.A.) in Warsaw decided to register 500,000 subordinated P1 series bearer bonds of the Bank with the face value PLN 100 each and assign them with the code PLBPCZT00080. The said bonds were registered on 1 September 2016.
- On 13 December 2016, pursuant to the Terms of Issue, the Bank redeemed 14,785 ordinary B2 series bearer bonds with the face value of PLN 147,8 million.

In order to fulfill the information obligations imposed by *Catalyst* and to ensure full transparency of operations, the Bank and the Group publish annual and mid-year reports.

The following person is responsible for ongoing investor relations in the Bank:

Bartosz Trzciński
Spokesman
e-mail: B.Trzcinski@pocztowy.pl
phone no. 022 328 74 71

All current and periodic reports submitted to Catalyst through EBI, other information regarding bonds issued by the Bank and confidential data as defined in MAR Regulation transferred through ESPI are available on Bank's website (*www.pocztowy.pl*).

14.8. Charter amendment procedure

Amendments to Bank Pocztowy's Charter require a resolution of its General Shareholders' Meeting and recording of the agreed amendments with the National Court Register. Prior to presenting the General Meeting with a draft resolution on Charter amendment, the Management Board passes a resolution regarding the proposed changes, adopting the draft resolution of the General Meeting. The draft is then presented to the Supervisory Board for approval. Pursuant to the Code of Commercial Companies, the resolution to amend the Charter is passed with the majority of three-fourths of votes. Pursuant to Article 34.2 of the Banking Law of 29 August 1997, amendments to bank's Charter require a permission of the Polish Financial Supervision Authority if they regard:

- the business name,
- registered office, core business and scope of operations of the Bank,

- bodies and their competencies, with special attention to competencies of Management Board members appointed with the approval of PFSA and decision-making principles, the basic organizational structure of the Bank, principles of making statements regarding property titles and liabilities, issuing of internal regulations and taking decisions to contract liabilities or use assets whose total value exceeds 5% of own funds of an entity,
- operation of the internal control system,
- equity and financial management principles,
- preference or restriction placed on shares with regard to the voting rights.

On 29 December 2016 amendments to the Bank's Charter as adopted by Extraordinary Shareholders' Meeting on 16 September 2016 were entered in the National Court Register. The amendments regarded adjusting the Charter to the amended Banking Law with respect to implementation of Articles 22a.4, 22b.1 and 22.3 of this Act, adjusting the Charter to the Act on state aid in bringing up children of 11 February 2016 and the obligation of the Supervisory Board to once a year present a report on implementation of the remuneration policy to the General Meeting.
The Charter is available on the Bank Pocztowy's website at www.pocztowy.pl.

14.9. Activities of Bank's corporate bodies

General Shareholders Meeting

Operation of the General Meeting
General Meetings are held in the registered office of the Bank in Bydgoszcz or in Warsaw. Ordinary General Meetings are convened by the Management Board of the Bank.

Extraordinary Shareholders' Meetings may be convened if necessary by the Management Board following its own decision or as requested by shareholders representing at least 1/20 of the share capital. The General Meeting is convened and prepared in accordance with the provisions of the Code of Commercial Companies and the Bank's Charter.

The Ordinary Shareholders' Meeting convened by the Management Board in line with the routine procedure is held once a year, within six months of the end of each financial year.
The Supervisory Board may convene an Ordinary Shareholders' Meeting if the Management Board fails to do so within the statutory deadline, or an Extraordinary Shareholders' Meeting if it deems it necessary.

Further, in specified cases, shareholders are entitled to call or request the calling of the General Meeting. The shareholders may participate in the General Meeting and vote in person or through a plenipotentiary.

The General Meeting decides on its own internal rules.

Issues to be raised at the General Meeting are presented to the Supervisory Board for consideration and approval.

Resolutions of the General Meeting, except for specific cases, are passed in open voting by an absolute majority of votes, unless the Code of Commercial Companies or the Charter require other, more restrictive manner of voting. Secret voting takes place when appointing and dismissing members of Bank's bodies or liquidators, deciding on their prosecution and in personnel related matters. Further, secret voting may take place if at least one shareholder present or represented at the General Meeting requests so.

Under the Charter, since the date of dematerializing any Bank's shares, the shareholder may participate in the General Shareholders' Meeting using electronic means of communication in accordance with the principles set out in the Operating Rules of the General Shareholders' Meeting.

The Supervisory Board of the Bank is appointed and dismissed by the General Shareholders' Meeting in secret voting.

The manner of resolving when appointing members of the Supervisory Board is determined by the common law, including Code of Commercial Companies and the Charter.

The Charter provisions describe the manner of appointing Supervisory Board members from among shareholders, including representation of individual shareholders in the body and principles of appointing independent members, their number and conditions they should fulfill.

The Bank's Charter restricts voting rights of the shareholders is such a way that at the General Shareholders' Meeting none of them can exercise more than 10% of the total voting rights existing in the Bank on the day of the General Shareholders' Meeting. For the purpose of determining the obligations of acquirers of large blocks of shares under the Act on offering, conditions governing the introduction of financial instruments to organized trading, and public companies (Act on offering) of 29 July 2005, such voting rights restriction shall not apply.

Voting rights restrictions do not apply to shareholders who were authorized to exercise their voting rights vested in shares representing more than 20% of the total number of votes in the Bank (or legal successors) on the day when the General Shareholders' Meeting adopted a resolution introducing the restriction. If, at any time, the interest held by the shareholder subject to restrictions falls below 20% of the total number of votes in the Bank (or legal successors), the shareholder will be authorized to exercise the voting rights from at maximum 20% of the total number of votes, even if his share in the total number of votes in the Bank (or legal successors) exceeded 20% again.

The provisions concerning voting rights restrictions apply as of the date of dematerializing any shares of the Bank.

Key powers of the General Shareholders' Meeting
General Shareholders' Meeting should in particular:

- analyze and approve Management Board's report on the activities of the Bank and financial statements for the previous financial year,
- decide on profit distribution / loss absorption;
- grant a vote of acceptance to members of the Bank's bodies.

Competencies
Further, the powers of the General Meeting include resolving on:

- appointment and dismissal of Supervisory Board members,
- amending the Charter,
- increasing or decreasing the share capital,
- approving the Operating Rules of the Supervisory Board,
- redemption of shares and conditions thereof,
- recognition and derecognition of special funds,
- issues of bonds,
- appointing of liquidators,
- other matters raised by the shareholders and Supervisory Board,
- determining the remuneration principles and employments terms for the Chairman of the Management Board so long as the number of shares in the share capital of Bank held by Poczta Polska S.A. exceeds 50% or if required by the Act on remunerating managers of certain entities of 3 March 2000,
- approving the policy of selecting and evaluating Supervisory Board members.

Operations
In 2016, the Ordinary Shareholders' Meeting was held on 30 June 2016. During the Meeting, 100% of the share capital was represented; During the meeting, the following resolutions were adopted:

- approving the Management Board's report on the activities of Bankin 2015,
- approving the financial statements of Bank for 2015,
- approving the Management Board's report on the activities of the Bank's Capital Group in 2015,
- approving the consolidated financial statements of the Bank's Capital Group for 2015,
- distribution of the profit of Bank for 2015,
- granting a vote of acceptance to members of the Management Board for 2015,
- granting a vote of acceptance to members of the Supervisory Board for 2015.

In 2016, six Extraordinary General Shareholders' Meetings were held. They adopted among others the following resolutions:

- changing the composition of the Supervisory Board;

- filling vacancies in the Supervisory Board in the 10th office term;
- amending the Charter;
- approving amendments to Supervisory Board Operating Rules;
- a report evaluating the implementation of the remuneration policy in the Bank in 2015.

During the Extraordinary Meetings, the shareholder PKO BP S.A. appointed Deputy Chairman of the Supervisory Board, while the shareholder Poczta Polska S.A. appointed Chairman of the Supervisory Board for 10th office term. Further, Extraordinary Meeting acknowledged the Report evaluating implementation of Corporate Governance Principles for Bank Pocztowy S.A. in 2015.

Supervisory Board

In accordance to the Code of Commercial Companies, the Management Board and Supervisory Board manage and supervise the Bank, respectively.
The Supervisory Board exercises general supervision of the Bank's operations.
The Supervisory Board acts collectively.
The Supervisory Board may delegate its members to perform specified supervisory activities independently.

Composition

The Supervisory Board consists of seven members appointed and dismissed by the General Shareholders' Meeting (until the date of dematerializing any Bank shares) and of five to nine members appointed and dismissed by the General Shareholders' Meeting (from the date of dematerializing any Bank shares), where the number of members of the Supervisory Board in a given term of office is determined by Poczta Polska S.A. (or its legal successor). If the Supervisory Board is elected by separate groups, the Supervisory Board is composed of five members. The members are appointed for a joint office term of three years.

The Charter provides a detailed description of cases when the number of Supervisory Board Members is reduced.

In each case when the number of Supervisory Board members is lower than that determined in the Charter, the Management Board is obliged to promptly, within 14 days at the latest, convene the General Shareholders' Meeting in order to organize a by-election.
The Charter provisions describe the manner of appointing Supervisory Board members from among shareholders before and after the date of dematerialization of shares, including representation of individual shareholders in the body and principles of appointing independent members, their number and conditions they should fulfill.

The mandates of members of the Supervisory Board expire as of the date of the General Meeting approving the financial statements for the last full financial year during which the members has held their positions. Should a new member be elected during an office term, their mandate expires along with those of the other members. Further, the mandate expires in the case of death, resignation or dismissal.

The tenth office term of the Supervisory Board commenced in April 2014 and it shall end as at the date of approving the financial statements of the Bank for 2016.

Before the day of dematerializing any shares of the Bank the Chairman of the Supervisory Board is appointed by the shareholder - Poczta Polska S.A. (or its legal successor), while the Deputy Chairman - by the shareholder PKO Bank Polski S.A. (or its legal successor), from among appointed members (also if the Supervisory Board is elected in separate groups). After the day of dematerializing any shares of the Bank the Chairman and the Deputy Chairman of the Supervisory Board is appointed by the shareholder - Poczta Polska S.A. (or its legal successor) from among appointed members (also if the Supervisory Board is elected in separate groups). Members of the Supervisory Board may elect the Secretary from among themselves.

Having undergone no changes by the date of preparing this report at 31 December 2016 the composition of the tenth office term of the Supervisory Board of the Bank was the following:

Name	Position	Appointment date	Term of office expiry date
Przemysław Sypniewski	Chairman	- Appointed Supervisory Board member on 3 August 2016. - Appointed the Chairman on 4 August 2016.	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.
Szymon Wałach	Deputy Chairman	- Appointed Supervisory Board member on 20 May 2016. - Appointed the Deputy Chairman on 9 June 2016.	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.
Magdalena Pacuła	Secretary	- Appointed Supervisory Board member on 14 April 2016. - Appointed the Secretary on 18 May 2016.	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.
Piotr Chełmikowski	Member	14 April 2016	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.
Katarzyna Kreczmańska-Gigol	Member	2 December 2016	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.
Marcin Mosz	Member	9 June 2016	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.
Jakub Słupiński	Member	2 December 2016	The current tenth office term of the Supervisory Board shall end as at the date of approving the financial statements of the Bank for 2016.

Competences of Members of the Supervisory Board of Bank Pocztowy

Przemysław Sypniewski – Chairman of the Supervisory Board
Graduated from Adam Mickiewicz University and won scholarship at Albert-Ludwigs-Universität Freiburg, Germany. In late nineties, deputy office director at Poczta Polska S.A. In 2005-2008 a member of Post Council for two office terms, during both acting as its Secretary.

Worked as a Supreme Control Chamber expert on postal market and postal regulations, and an EU Commission expert on postal legislation and implementation of postal directives.
The founder and first chairman of the Postal Institute, Association of Citizens for Postal Market.

Szymon Wałach – Deputy Chairman
Since May 2010 working for PKO Bank Polski, first as an adviser to the Chairman of the Management Board, then since 2011 as Director of Retail Client Function managing the retail product offer and client segments. At present, acting Director of Analyses and Strategy Function.
Working in the banking sector since 2000. He commenced his professional career at Salomon Smith Barney, N.Y., in investment banking. In 2002 joined the Warsaw office of The Boston Consulting Group and focused on the financial sector. In 2004-2010 worked for Pekao SA, acting as manager in Consumer Finance. Graduated from Montclair State University, New Jersey, majoring in Finance. Chairman of the Decision-Making Committee at Visa Polska and member of supervisory boards in eService, PKO Życie TU SA, PKO TU SA and KredoBank.

Magdalena Pacuła – Secretary
Graduated from Oskar Lange University of Economics in Wrocław. Completed post-graduate Organization and Management studies at Leon Kozminski University with EQUIS accreditation. Completed a series of project management, HR management and leadership courses.
She has spent her entire professional life with Poczta Polska S.A. At present she is Deputy Director of Poczta Polska Management Board Office. Formerly (since 2005) held a number of managerial positions at Poczta Polska S.A. (Deputy Director of District Post Office; Deputy Director in Regional Branch of Infrastructural Function; Director, Infrastructural Function; Director of Philately and Trade Office. During many years spent with such a large and complex structure she has gained substantial knowledge and practical experience in management, large team leadership, investment and sales. She has originated a number of product strategies for retail trade and philately. A hands-on practitioner preparing and implementing highly complex project solutions.

Piotr Chełmikowski – Member
Economist with experience in corporate risk management and banking. Since 2014 expert on risk and settlement in LOTOS Serwis Sp. z o.o. in charge of contract security regarding financial risk and compliance. Formerly, in 2008-2013, Director of the Northern Macroregion for Corporate Banking in Bank Millennium S.A.
In 1985 graduated from Transport Economics Faculty, University of Gdańsk (M.Sc. in economics). Completed a series of people management, banking and risk management courses.

Katarzyna Kreczmańska-Gigol – Member
Graduated from Warsaw University of Economics (M.Sc. in economics in 1992). In 2006 completed Ph.D. studies at College of Management and Finance of the university and obtained the degree. In 2014 obtained the degree of doktor habilitowany in economics, majoring in finance. Since 2007 working at Warsaw University of Economics, first as assistant professor in the Department of Finance, at present as Associate Professor at Institute of Finance. From 2008 she has been Manager of Postgraduate Debt Collection Studies and in 2015-2016 Manager of Postgraduate Studies on Financial Security in Trade. She has been delivering all types of courses (B.A., M.A., postgraduate and Ph.D.) and cooperating with business entities as an advisor and trainer. She has authored a number of publications on banking and corporate finance.
Currently on the position of Managing Director of the Finance Function in Poczta Polska. Formerly for years worked for the banking sector, dealing mostly with credit facilities, among others in PBK SA (1992-1995; at present Pekao SA), Bank Wschodnio-Europejski SA (1995-2007; at present Meritum Bank SA) and Bank Amerykański w Polsce SA (1996-2007; at present DZ Bank SA). Her professional experience includes corporate governance (as a supervisory board member). Currently Supervisory Board Member in Bank Pocztowy and in Dom-Invest Sp. z o.o. (a company owned by Military Property Agency).

Marcin Mosz – Member
Director, Corporate Development Department at PKO Bank Polski S.A. in charge of supervising companies of the PKO Bank Polski Capital Group and other equity investments, M&A transactions, sales of assets in PKO Bank Polski, strategic corporate controlling and reporting in the Capital Group.
He has gained substantial experience in investments, M&A, corporate strategy and reorganization working in Polish and international financial institutions (Barclays, ABN AMRO), where he was in charge of winning and supporting transactions (mainly M&A, IPO and other equity and financing transactions) in the financial institutions sector and in Central and Eastern Europe.
His professional experience includes corporate governance (among others, gained when working as a supervisory board member). At present, apart from working in the Supervisory Board of the Bank, a member of supervisory boards at Kredobank, Ferrum, PKO Leasing and Qualia Development. Graduated from Warsaw University of Economics (majoring in Finance and Banking, M.Sc.).

Jakub Słupiński – Member
Graduated from AGH University of Science and Technology (majoring in Automatics) and of Swinburne University of Technology in Melbourne (majoring in Management). In 1988-1995, a founder and CEO of a major Polish IT pioneer company named Qumak (listed). In 1996 originated and managed an advisory and training company PM Doradztwo Gospodarcze, where he has been a partner and advisor.
He has substantial experience in corporate governance, working as a member of supervisory boards in a number of companies (both co-owned by the State Treasury and private ones).
A Council Member at Polish Chamber of Training Firms and a management board member of its Małopolska branch (Family Business Initiative Association).
He has originated and been in charge of implementation of large advisory and training engagements. Strongly involved in strategic advisory and succession planning activities.

Changes in the composition of the Supervisory Board
As at 1 January 2016, the composition of the Supervisory Board was the following:

- Jerzy Jóźkowiak - Chairman,
- Jakub Papierski – Deputy Chairman,
- Piotr Michalski – Secretary,
- Paweł Borys - Member,
- Mariusz Czyżak - Member,
- Bogusław Grabowski - Member,
- Janusz Wojtas –Member.

Janusz Wojtas resigned from the position of the Supervisory Board Member as of 1 March 2016.
Piotr Michalski resigned from the position of the Supervisory Board Member as of 5 April 2016.
Jerzy Jóźkowiak resigned from the position of the Supervisory Board Member as of 7 April 2016.

On 14 April 2016 Extraordinary Shareholders' Meeting passed resolutions dismissing Mariusz Czyżak from the Supervisory Board and appointing Mirosław Jakubowski, Magdalena Pacuła, Ryszard Stopa and Piotr Chełmikowski members of the Supervisory Board for 10th office term.
At the same time, during the Extraordinary Meeting on 14 April 2016, the shareholder Poczta Polska S.A. recommended Ryszard Stopa as the candidate for the Supervisory Board Chairman.

Paweł Borys resigned from the position of Supervisory Board Members as of 30 April 2016.
On 18 May 2016 the Supervisory Board appointed Magdalena Pacuła its Secretary.

On 20 May 2016 Extraordinary Shareholders' Meeting appointed Szymon Wałach to the Supervisory Board for the 10th term of office.

Jakub Papierski resigned from the position of Supervisory Board Members as of 31 May 2016.

On 9 June 2016 Extraordinary Shareholders' Meeting appointed Marcin Mosz a Member of the Supervisory Board for the 10th term of office. Also on 9 June 2016, during Extraordinary Meeting, the shareholder PKO BP S.A. recommended Szymon Wałach for the position of Deputy Chairman of Supervisory Board.

On 3 August 2016 Extraordinary Shareholders' Meeting of the Bank was held and passed the following resolutions:

- on dismissing Bogusław Grabowski from the Supervisory Board of the Bank;
- on dismissing Mirosław Jakubowski from the Supervisory Board of the Bank;
- on appointing Przemysław Sypniewski a Member of the Supervisory Board;
- on appointing Bogdan Pęk a Member of the Supervisory Board.

Effective from 4 August 2016, Przemysław Sypniewski, recommended by the shareholder Poczta Polska S.A., was appointed the Supervisory Board Chairman. Thus, Ryszard Stopa had held the position until 3 August 2016.

Ryszard Stopa resigned from the position of Supervisory Board Members as of 4 October 2016.

Bogdan Pęk resigned from the position of Supervisory Board Members as of 10 October 2016.
On 2 December 2016 Extraordinary Shareholders' Meeting appointed Katarzyna Kreczmańska-Gigol and Jakub Słupiński Supervisory Board Members for the 10th term of office.

Family connections
No family connections occur between members of the Management Board and Supervisory Board.

Operations
The Supervisory Board operates pursuant to the Operating Rules of the Supervisory Board developed by the Board and approved by the General Shareholders' Meeting. Its meetings are called in the manner determined in the Rules, at least four times in each financial year.
Resolutions of the Supervisory Board may be passed if at least half of its members including the Chairman or Deputy Chairman are present during a meeting and all members have been invited. A Supervisory Board member may participate in the passing of resolutions voting in writing through the agency of another member.

The Supervisory Board may pass resolutions in writing or using remote communication media.
The passing of resolutions pursuant to the above procedures does not include election of the Secretary, appointing, suspending and dismissing of Management Board members.

Resolutions of the Supervisory Board are adopted with an absolute majority of votes cast. In case of a tie, the Chairman has the deciding vote if present at the meeting.

In the report on its activities in 2016, the Supervisory Board stated that its members had necessary knowledge and professional experience being specialized in management, law and economics.

Further, it expressed an opinion that in 2016 its operations were efficient and all members were duly involved.

The above report includes recommendations for General Shareholders' Meeting regarding a vote of acceptance to members of the Supervisory Board for 2016.

Once a year, the Supervisory Board prepares the following documents and presents them to the General Shareholders' Meeting:

- assessment of the company's standing including evaluation of its internal control, risk management and compliance systems, as well as internal audit; the assessment includes all material controls with special focus on financial reporting and operations;

- report on the activities of the Supervisory Board including information on its composition and committees, its members meeting independence criteria, number of meetings held by the Supervisory Board and its committees during the reporting period, a list of key issues discussed, self-assessment and recommendations to the General Shareholders' Meeting regarding the vote of acceptance to its members for the previous financial year.

Supervisory Board's Meetings
The agenda and issues to be discussed during the Supervisory Board's meetings held in 2016 were determined by the Chairman of the Supervisory Board resulted from the ongoing operations of the Bank, and included issues raised by the Management Board and Supervisory Board Members.

Supervisory Board's decisions had the form of resolutions, decisions, approvals regarding Management Board's motions and information materials presented by the Bank.
In 2016 the Supervisory Board held seven meetings and supervised Bank's operations on an ongoing basis.

Pursuant to Supervisory Board Operating Rules, managers of internal audit and compliance units participate in its meetings if the agenda includes their responsibilities or supervision of internal controls and compliance risk management.

At least once a year managers of internal audit and compliance units participate in a Supervisory Board meeting discussing activities performed by these units.

Audit Committee

The Audit Committee operates within the Supervisory Board.

The Audit Committee acts pursuant to the applicable provisions of law, the Act on statutory auditors, their self-governing organization, entities authorized to audit financial statements and on public oversight of 7 May 2009 (the "Act") and to the Operating Rules of the Audit Committee.
Its members are appointed by the Supervisory Board from among its members. Its operational rules are approved by the Supervisory Board.

The Supervisory Board may dismiss a member of the Audit Committee from the position of the Chairman of the Audit Committee at any time, at the same time keeping his position of a member and award the function to another member of the Audit Committee.
The term of office and the mandate of an Audit Committee member expire with the end of the term of office and the mandate in the Supervisory Board of the Bank.

The Audit Committee acts jointly.

The Audit Committee is in particular responsible for:

- monitoring of the financial reporting process,
- monitoring of effectiveness of the internal control systems, internal audit and risk management,
- monitoring of financial audit,
- monitoring of independence and unbiased approach of the certified auditor and the entity authorized to audit financial statements,
- recommending an entity authorized to audit financial statements to the Supervisory Board for the purpose of auditing or reviewing financial statements of the Bank.

According to the Operating Rules of the Audit Committee approved by the Supervisory Board on 13 October 2016, the Audit Committee consists of at least three people, including the Chairman, appointed by the Supervisory Board from among its members. At least one Audit Committee member should meet the independence criteria as defined by the Act and be an audit or accounting professional. At present, Piotr Chełmikowski, the Audit Committee Chairman, meets the criteria.
The Audit Committee meets at least once a quarter, at dates determined by its Chairman.

The meetings are convened by the Chairman upon his own decision or following a motion of its member. If the Chairman cannot convene a meeting for any reason, it may be convened by another Audit Committee member appointed by the Chairman. The Committee meetings may be called following a motion of another Supervisory Board Member, the Management Board, an internal or external auditor of the Bank, in particular if the Internal Audit Head escalates material disputable issues with the Management Board. The Audit Committee adopts resolutions if the Audit Committee meeting is attended by at least a half of its members and if all members have been appropriately invited. The Audit Committee may pass resolutions in writing or using remote communication media.

The Audit Committee meetings can be held if at least a half of members are present (quorum). Resolutions of the Audit Committee are approved with an absolute majority of votes cast by its members present at the meeting. If the number of votes for and against a given resolution is equal, the Chairman of the Audit Committee has a deciding vote.
If necessary, the Audit Committee, following an initiative of its Chairman or another member appointed by the Chairman, may pass resolutions among the meetings in writing or using remote communication media.

Changes in the composition of the Audit Committee
Composition of the Audit Committee from 31 December 2015 to 5 April 2016:

- Bogusław Grabowski – Chairman;
- Paweł Borys – Member;
- Piotr Michalski – Member.

On 31 March 2016 Piotr Michalski resigned from the position of the Supervisory Board Member effective from 5 April 2016.

On 30 April Paweł Borys resigned from the position of the Supervisory Board Member.

Since the minimum number of members required is three, the Audit Committee had not met until the vacancies were filled.

On 18 May 2016 the Supervisory Board appointed Mirosław Jakubowski and Jakub Papierski members of the Audit Committee.

On 31 May 2016 Jakub Papierski resigned from the position of the Supervisory Board Member.

On 9 June 2016 the Supervisory Board appointed Marcin Mosz a member of the Audit Committee.

On 3 August 2016 Extraordinary Shareholders’ Meeting dismissed Bogusław Grabowski and Mirosław Jakubowski from their positions in the Supervisory Board.

In relation to the above, on 31 August 2016 the Supervisory Board appointed Magdalena Pacuła a member and Piotr Chełmikowski the Chairman of the Audit Committee.

As at 31 August 2016 and 31 December 2016 the composition of the Audit Committee was the following:

- Piotr Chełmikowski - Chairman,
- Magdalena Pacuła - Member,
- Marcin Mosz - Member.

The Audit Committee discloses reports on its activities performed in previous financial years to the shareholders. The reports are attached to materials for General Meeting for information purposes.

Pursuant to the Operating Rules of the Audit Committee, the head of the internal audit unit participates in all Committee meetings and provides the Committee with:

- conclusions and recommendations arising from completed audit engagements (on a quarterly basis);

- information regarding the status of the recommendations whose implementation deadline has passed, along with information on post-audit recommendations whose implementation deadline has been postponed (on a quarterly basis);
- a report on the activities of the internal audit unit (once a year);
- annual and three-year audit plans;
- information on implementation of the annual audit plan;
- other documents and data (as expected by the Committee and required by appropriate resolutions and recommendations of PFSA).

At least once a year, the internal audit unit head may participate in an Audit Committee meeting not attended by Management Board members.

Internal Audit Department, which carries out independent control of adequacy and efficiency of the risk management and internal control system, is supervised by the Management Board Chairman. Direct access to the Management Board members, Audit Committee and Supervisory Board, as well as determined information path allowing the Internal Audit Department to report directly to both Chairman of the Management Board and Audit Committee ensure independence of the internal audit unit.

Appointment Committee

The Appointment Committee is a permanent committee of the Supervisory Board, supporting its activities.

It is appointed for the office term of the Supervisory Board and consists of at least three people appointed by a Supervisory Board resolution, to include its Chairman appointed by the Supervisory Board from among Committee's members.

The Supervisory Board elects members of the Committee and its Chairman during the first meeting of a given term of office.

Every member of the Committee may be dismissed at any time by a resolution of the Supervisory Board. At any time the Supervisory Board may dismiss a member of the Committee from the position of the Chairman of the Committee, at the same time keeping his position of a member and award the function to another member of the Committee.
If the term of office of a Supervisory Board member elected to the Committee expires before the end of the term of office of the entire Supervisory Board or if he/she resigns from his/her position in the Committee, the Supervisory Board shall elect a new Committee member to replace such a member for the period until the end of the term of office of the Supervisory Board.
The term of office and the mandate of an Committee member expire with the end of the term of office and the mandate in the Supervisory Board of the Bank.
The Appointment Committee acts jointly.
The operating rules of the Committee are approved by the Supervisory Board.

The Appointment Committee is in particular responsible for:

- evaluating of candidates for the position of Management Board Chairman and Members,
- evaluating of holders of the positions of Management Board Chairman and Members.

The Appointment Committee evaluates qualifications of candidates for the positions of the Management Board Chairman or Members and the current holders of these positions upon:

- selecting the new Management Boards (for candidates),
- motioning to PFSA for a permit for the Bank to carry out extended operations (for current position holders),
- occurrence of new circumstances described in the "Policy of selecting and evaluating Management Board members" (for current position holders).

The Appointment Committee holds meetings if required due to planned changes in the composition of the Management Board, if its office term expires, or in other cases determined in the Policy of selecting and evaluating Management Board members. The meetings are convened by the Chairman upon his own decision or following a motion of its member or of the Management Board of the Bank. If the Chairman cannot convene a meeting for any reason, it may be convened by another Committee member appointed by the Chairman. The Committee meetings are chaired by its Chairman, and in his absence, by a member appointed by the Chairman.

The Appointment Committee meetings can be held if at least two members are present. Evaluation decisions are made with an absolute majority of votes cast by its members present at the meeting. In the event of a tied vote, the Chairman will have the deciding vote.

As at 31 December 2015 the composition of the Appointment Committee was the following:

- Jerzy Jóźkowiak – Chairman,
- Jakub Papierski – Member,
- Janusz Wojtas – Member.

As at 31 December 2016 the composition of the Appointment Committee was the following:

- Przemysław Sypniewski - Chairman,
- Szymon Wałach - Member.

In 2016 and by the date hereof, the Appointment Committee held two meetings.

Due Diligence Committee

The Supervisory Board adopts a resolution appointing the Due Diligence Committee composed of at least 3 members, including at least one member of the Supervisory Board appointed by the Supervisory Board, at least one member of the Management Board appointed by the Management Board, the Legal Department Director or a person designated by the Director.

A Member of the Supervisory Board is the Chairman of the Due Diligence Committee.

If the Supervisory Board appoints more than one of its members to the Due Diligence Committee, it specifies who will act as the Chairman of the Due Diligence Committee in the resolution establishing the Due Diligence Committee.

Resolutions of the Due Diligence Committee are passed by simple majority of votes cast. The provisions of the Bank's Charter concerning the Supervisory Board and the Supervisory Board regulations apply to the works of the Due Diligence Committee. Upon its request decisions of the Due Diligence Committee are approved by the Supervisory Board of the Bank in the form of a resolution.

The responsibilities of the Due Diligence Committee have been specified in the Principles of due diligence organization and management in Bank Pocztowy S.A.

No other Supervisory Board committees were established.

Management Board

Appointing and dismissing Management Board Members
Pursuant to the Bank's Charter, the Management Board consists of at least three and up to five members appointed by the Supervisory Board. It consists of the Chairman, Deputy Chairmen (including the First Deputy) and Members. They are appointed for a joint three-year office term.

At least half of Management Board members, including the Chairman, should be the residents of Poland and speak Polish.

The mandates of members of the Management Board expire as of the date of the General Meeting approving the financial statements for the last full financial year during which the members have held their positions. Further, the mandate expires in the case of death, resignation or dismissal.

The mandate of a Management Board Member appointed during the term of office expires at the same time as the mandate of the remaining members.

According to the Code of Commercial Companies, the General Meeting can dismiss or suspend a Management Board member.

The Management Board Chairman, Deputy Chairmen and other Members are appointed and dismissed by the Supervisory Board, which considers their qualification to hold these positions and acts in accordance with the Banking Law and Policy of selecting and evaluating Management Board Members of Bank Pocztowy S.A.

Appointing the Chairman and Member of the Management Board in charge of supervising the management of key risks, as well as appointing Management Board members requires an approval of PFSA. The Supervisory Board motions for such an approval.

The Management Board Chairman is in charge of personnel management, internal audit and organization of Management Board's work.

Certain Management Board Member(s) is (are) entrusted with supervising the management of key risks.

Composition

As at 31 December 2016 and as at the date of approving this Report the composition of the Management Board was the following:

- Sławomir Zawadzki – Chairman,
- Jerzy Konopka – Member,
- Robert Kuraszkiewicz – Member,
- Magdalena Nawara – Member,
- Krzysztof Telega – Member.

Changes in the composition of the Management Board

As at 1 January 2016, the composition of the Management Board was the following:

- Szymon Midera – Chairman,
- Paweł Spławski – Deputy Chairman,
- Hubert Meronk – Member,
- Michał Sobiech – Member.

Michał Sobiech resigned from the position of the Member of the Management Board of the Bank as of 29 February 2016.

On 17 December 2015 the Supervisory Board of the Bank adopted a resolution to request a consent to appoint Magdalena Nawara to the position of a Member of the Management in charge of key risks from the Polish Financial Supervision Authority. On 23 February 2016, the Polish Financial Supervision Authority gave its consent for the appointment of Magdalena Nawara to the position of a Member of the Management Board of the Bank. Magdalena Nawara assumed her duties as a Member of the Management Board of the Bank on 1 March 2016.

On 28 June 2016, in relation to the 9th office term of the Management Board end falling on the date of the Ordinary General Shareholders' Meeting of the Bank approving the financial statements for 2015, i.e. on 30 June 2016, the Supervisory Board passed resolutions regarding appointment of the following Management Board members for the 10th term of office effective from 1 July 2016:

- Sławomir Zawadzki, appointed Deputy Chairman of the Management Board, acting Chairman of the Board,
- Magdalena Nawara, appointed a Member of the Management Board,
- Jerzy Konopka, appointed a Member of the Management Board,
- Krzysztof Telega, appointed a Member of the Management Board,
- Robert Kuraszkiewicz, appointed a Member of the Management Board.

Further, the Supervisory Board appointed Sławomir Zawadzki acting Chairman of the Management Board. At the same time, the Supervisory Board authorized its Chairman and Secretary to motion to the Polish Financial Supervision Authority (PFSA) for a consent to appoint Sławomir Zawadzki Chairman of the Management Board. On 29 July 2016, the motion was submitted to PFSA, which approved it on 13 September 2016 and on 21 September 2016 the Supervisory Board of the Bank appointed Sławomir Zawadzki Chairman of the Management Board.

Qualifications and professional experience of Management Board Members

Sławomir Zawadzki
Chairman
In charge of strategic management and IT

Appointed the Chairman in September 2016. For many years working in the financial sector. Former Deputy Chairman of the Management Board, acting Chairman in Bank Ochrony Środowiska S.A. In 2007-2011 an advisor to the President of the National Bank of Poland and Deputy Chairman of its Budget Committee, representing the Central Bank in the Council of the Bank Guarantee Fund. From 1998 to 2001 Deputy Chairman in charge of finance in Bank Pocztowy S.A. Before assuming the position, managed the Team for Cooperation with Foreign Financial Institutions in PKO BP and Finance Department in Korporacja Brokerów Ubezpieczeniowych Protektor S.A. In 1997-98 Undersecretary of State in European Integration Committee Office supervising EU funds and foreign aid for Poland.

A former member of the Management Board of Nafta Polska S.A. and Management Board Member - Director in charge of economics and finance in ORLEN Petrogaz Płock. In 2003-2006 worked in the Municipal Council of the capital city of Warsaw as Director in Investment Office and was in charge of planning, monitoring and settlement of investments included in the city budget.

Recently, CEO in IT companies, FinCode Sp. z o.o. and Bazy i Systemy Bankowe Sp. z o.o., specialized in developing of IT systems for banks and other financial institutions

Completed Ph.D. studies in economics at Management and Finance College of Warsaw University of Economics; MBA at Business Management Department, University of Wisconsin (USA); a graduate of Warsaw University of Technology, Faculty of Power and Aeronautical Engineering. In 1995-96 scholarship in the U.S. Congress under East Central European Scholarship Program administered by the University of Georgetown (Washington, USA).
Interested in macroeconomics, in particular monetary policy, operations of financial institutions and markets, IT systems supporting management efficiency and security in financial institutions. Hobbies: mountain hiking, basketball.

Magdalena Nawara
Member
In charge of risk

Appointed the Management Board Member in March 2016. Working for the Bank since February 2011, initially as Director of the Market Risk, Operational Risk and ICAAP Department. In 2012 she was appointed the Risk Head in charge of: the implementation of the comprehensive risk management strategy supporting business initiatives, providing an efficient credit approval system, pre-collections, collections and restructuring, ICAAP and the implementation of solutions which allow for efficient management of credit risk, liquidity risk, market risk and operational risk. Before, for over ten years (1999-2011) she worked in Bank BPH in risk management and liquidity management participating in merger and spin-off processes in the Bank BPH.

She graduated from the Finance and Banking Department at Cracow University of Economics.

Jerzy Konopka
Member
In charge of Finance

Appointed the Management Board Member in June 2016. Before, from 2007 to 2010 worked as Sales Director in Sales Development Department of PKO BP, and from 2010 on was in charge of cooperation with a group of strategic clients. In 2004-2007 worked for Korporacja Polskie Stocznie SA (KPS SA) as acting Chairman of the Management Board, formally holding the position of its member, then Deputy Chairman in charge of managing current operations of the company. At the same time, from February to May 2006 he was Deputy CEO of Stocznia Gdynia SA, managing the finance function, supervising controlling and preparing the shipyard restructuring plan. In 2002-2005 worked in Agencja Rozwoju Przemysłu SA, first as Deputy Director, Department of Restructuring Project Analyses, then as Director, Shipyard Center Department, where he was in charge of the shipyard sector restructuring. Prior to 2002, worked for seven years in PEKAO S.A., first (for a year) as Deputy Director of Project Financing Department, then as Deputy Director in charge of corporate segment in a branch.

Graduated from Karol Adamiecki University of Economics in Katowice.

Krzysztof Telega
Member
In charge of Business

Appointed the Management Board Member in June 2016. For over 20 years working in the banking sector. In 2008-2014 Deputy Chairman of Management Board in Bank Ochrony Środowiska S.A. in charge of corporate banking. In 2005-2008 as Managing Director, Corporate Banking Function, PKO PKO Bank Polski S.A., was in charge of cooperation with enterprises and sales network management. In 1998-2005 worked in BRE Bank Capital Group. As a Management Board Member of BRE Leasing Sp. z o.o. he was in charge of risk and collection; as Management Board Chairman in Polfactor S.A. he supervised sales and as Management Board Chairman in PTE Skarbiec-Emerytura S.A. was in charge of capital market. In 1991-1998 worked in Polski Bank Rozwoju S.A., for the last two years as a Management Board Member.

Graduated from Foreign Trade Faculty, Warsaw School of Economics and Strategic Management in Banking Programme, INSEAD, Fontainebleau, France.

Robert Kuraszkiewicz
Member
In charge of support and cooperation with Poczta Polska

Appointed Management Board Member in June 2016. Prior to that, for a year acting Managing Director in Student Depot Sp. z o.o. and was in charge of developing a network of private student hostels. In 2012-2016 worked in Renewable Energy Association, first as Deputy Chairman, and for the last two years, as Chairman of the Management Board. In 2006-2016 cooperated with the largest renewable energy sector investors in Poland, such as GEO Renewables Sp. z o.o., being in charge of obtaining funding for wind farms, and with EDP Renewables Polska Sp. z o.o. In 2013-2014 Chairman of the Management Board in High Tech Project Sp. z o.o. In 2002-2006 CEO and Chairman of the Management Board in ContactPoint Sp. z o.o., one of the first companies in Poland offering outsourcing and CRM development services. Member of supervisory boards in a number of companies, to include KGHM, XIV NFI, Skystone Capital, and in 1999-2000, Bank Pocztowy.
Graduated from Adam Mickiewicz University in Poznań. Studied finance at University of Wisconsin Lacrosse under East Central European Scholarship Program. Obtained Financial Management Certificate at Georgetown University Washington DC. In 1998 took internship at Center for Strategic and International Studies in Washington.

Competences
The Management Board manages the Bank and represents it before third parties in the scope determined by the Code of Commercial Companies, the Bank's Charter and Operating Rules of the Management Board.

When performing its tasks, the Board makes decisions in the form of resolutions; in particular, the Board:

- determines the Bank's strategy,
- determines the pricing policy,
- determines the annual financial plan,
- determines the employment and remuneration policy,
- approves the Operating Rules of the Management Board,
- approves the Organizational Rules of the Bank,
- appoints proxies,
- designs and ensures efficient operation of the management system,
- makes decisions regarding liabilities or assets whose total value related to a single entity exceeds 5 percent of equity or grants the related general or specific authorization regarding cash investments in domestic and foreign securities,
- determines the principles of prudent and stable management of the Bank to include:
  - risk management policy,
  - internal control principles,
  - capital management principles, including internal capital estimation,
  - variable compensation component policy,
- determines the general level of the risk incurred by the Bank and appropriately adjusted internal limits that reduce the risk specific to individual operation areas,
- determines the Bank's compliance risk policy,
- approves internal procedures of the Bank regarding estimation of internal capital, capital management and planning,
- approves the Bank's information policy.

Operation
The Management Board operates pursuant to the Management Board Operating Rules developed by it and approved by the Supervisory Board. Chairman of the Board manages its operation. Its meeting are convened and chaired by the Chairman, and in his absence, the First Deputy Chairman. In the absence of the latter, a Board Member appointed pursuant to the order determined in a resolution of the Management Board.

Resolutions of the Management Board are passed with an absolute majority of votes. In case of a tie, the Chairman has the deciding vote if present at the meeting. A resolution may be passed provided that all the members of the Management Board have been properly informed about the planned meeting.

Voting is open, and a secret voting may be applied with regard to personal issues of Management Board members. Meetings are held and minutes taken in Polish. If non-Polish speaking members participate in a meeting, a translator is provided. Minutes are signed by Board Members present at a given meeting.

Pursuant to the Management Board Operating Rules, the internal audit unit head participates in Management Board meetings if their agenda includes tasks performed by the unit and supervision of internal controls.

Pursuant to Management Board Chairman's decision, effective from 12 July 2016 the internal audit unit head participates in all Management Board meetings.

The Bank has the following committees:

- Assets and Liabilities Committee (ALCO),
- Loan Committee (LC),
- Operational Risk Committee (ORC),
- IT Initiatives Prioritization Committee (ITIPC),
- Loan Appellation Committee (LAP),
- Project Portfolio Management Committee (PPMC),
- IT Architecture Committee (ITAC).

The committees operate based on internal regulations approved by the Management Board of the Bank. In principle, these regulations described tasks and competences of a given committee.

The Management Board Members are included in the following committees: Loan Committee, Assets and Liabilities Committee and Operational Risk Committee.

Remuneration and terms of employment of the Management Board members

Due to the existing shareholding structure of the Bank, it is indirectly controlled by the State Treasury. Therefore, it is obliged to apply the remuneration policy as determined in the Act on remunerating managers of certain entities of 9 June 2016 (Journal of Law of 2016 item 1202 as amended) effective since 9 September 2016. Pursuant to the Bank's Charter, remuneration of the Management Board Chairman is determined by a resolution of the General Meeting, while remuneration of the other Management Board members is determined by a resolution of the Supervisory Board.

Employment contracts concluded with Management Board Members determine their scope of duties, confidentiality and non-competition obligations, as well as remuneration. Pursuant to the employment contracts, Management Board Members are entitled to a monthly pay equal to four times average monthly remuneration in the enterprise sector excluding profit sharing bonuses paid in the fourth quarter of the prior year announced by the President of the Central Statistical Office. Depending on financial or general performance of the Bank in a given financial year, the Supervisory Board may grant Management Board Members an annual bonus of three times their average monthly base pay received in the prior year. Chairman of the Management Board is granted an annual bonus by the General Meeting following a motion of the Supervisory Board.

Further, Management Board members are entitled to the following additional bonuses:

- a severance pay upon old-age or disability retirement;
- a jubilee bonus;
- additional health, property and personal insurance the total amount of which cannot exceed twelve times average monthly remuneration in the enterprise sector in each consecutive employment year, net of profit sharing in the fourth quarter of the prior year, announced by the President of the Central Statistical Office.

The Bank may terminate an employment contract upon a three-month notice period if a Management Board Member is dismissed before the end of an office term or not appointed for the subsequent office term. Should a Management Board Member be dismissed and their employment contract terminated, they are entitled to a severance pay of three times monthly base pay. A Member is not entitled to the severance pay if the dismissal has resulted from a flagrant breach of key Management Board Member's obligations. Further, it expires should a Member fail to provide information and documents specified in their contract to another Member taking over their duties. A Member may terminate their contract upon a three-month notice. Resigning from a position in the Management Board is understood as termination of the employment contract.

Further, a non-competition arrangement has been concluded with one Management Board Member. Pursuant to this arrangement, without Bank's written consent, the Member cannot carry out any activities competitive to those of the Bank within 12 months of the expiration of their employment contract. In relation to this arrangement, the Member is entitled to damages of PLN 780 thousand, payable in 12 monthly installments. Should the non-competition arrangement be breached, the Bank is not obliged to continue paying the damages and the Member is obliged to pay a contractual fine equal to damages received to date. Non-competition arrangements include relevant termination clauses.

No such arrangements have been concluded with other Management Board Members.

In 2016, the total remuneration paid to Management and Supervisory Board Members of the Bank and its subsidiaries amounted to PLN 6,943 thousand vs. PLN 5,937 thousand in the prior year.

Remuneration paid and payable to members of the Management and Supervisory Board of the Bank by subsidiaries (PLN'000)

	2016	2015	change 2016/2015
Management Board	**3,872**	**3,466**	**406**
Short-term employee benefits (payroll, bonuses and payroll charges)	2,747	2,674	73
Termination benefits	1,125	792	333
Supervisory Board	**3,071**	**2,471**	**600**
Short-term employee benefits (payroll, bonuses and payroll charges)	3,071	2,471	600
Total	**6,943**	**5,937**	**1,006**

Securities issued by the Bank and held by Management Board Members

As at the date hereof, Management Board Members held no securities issued by the Bank or its subsidiaries.

15. Definitions and acronyms

SREP	Supervisory Review and Evaluation Process- a supervisory tools supporting prudent supervision based on risk analytics understood as an organizational concept subjecting processing, organizational solutions and resource allocation to risk ratios
BPV	Basis Point Value - a measure denoting an amount by which a position (cash flows, instruments, portfolio) will change when the interest rates increase upwards
C/I (cost/income)	cost effectiveness ratio calculated as the total operating expense divided by total operating income
CAR	Capital Adequacy Ratio, solvency ratio
cross-selling	the action or practice of selling an additional product or service to an existing customer or selling two or more products to one customer at a time
CRR	Capital Requirements Regulation - Regulation of the European Parliament and of the Council (EU) no. 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, amending the Regulation (EU) no. 648/2012
DTI	Debt to Income ratio - the relation of all debt service costs and cost of other financial liabilities to the customer's income
FRA	Forward Rate Agreement which determines the rate of interest applicable in future to a given amount denominated in a transaction currency for a predetermined period
IBNR	Incurred But Not Reported – impairment loss for losses incurred but not reported, calculated in accordance with IAS 39
IPO	Initial Public Offering, the first time that the stock of a private company is offered to the public.
Banking book	the Bank's balance sheet and off-balance sheet items which were not classified to the trading book

Trading book	portfolio of off-balance sheet assets and transactions entered into to gain profits from short-term market fluctuations
lean management	enterprise management concept, where the business is aligned with the market environment by way of organizational and functional transformation; a slow and continuous rationalization of the entire organization and its external relations by way of introducing extensive changes in the business operations, assets structure and management and in professional skills and staff attitudes
LTV	Loan To Value ratio is the relation of the loan granted to its collateral
Microbranches	type of Bank offices in its distribution network, special zones at post offices with the full access to databases, systems and bank applications operated by the Bank's staff
NPL	Non Preforming Loans, the credit risk ratio calculated as a relation of gross impaired loans to the gross loans and advances to clients
NPL coverage	ratio calculated as the relation of the impaired loss on loans and advances with recognized impairment to the gross loans and advances granted to clients
PD	Probability of Default, credit risk assessment method
Agency	bank outlet where the client may use Bank services managed by an independent entity cooperating with the Bank based on franchise agreement, in which the Bank holds no shares
Bank offices	the Bank’s network including branches, offices and Microbranches
Postal Financial Services Offices	offices created in the Poczta Polska network before the end of 2009, offering bank and insurance products of the Bank and other products offered by Poczta Polska
Postal Financial Zones	offices created in the Poczta Polska network, offering mostly financial products and services
PSI ratio	scoring model efficiency measures, credit risk assessment method

Recommendation C	Recommendation of the Polish Banking Supervisory Authority amended in 2002 and concerning management of exposure concentration risk
Recommendation P	Recommendation amended by the Polish Financial Supervision Authority in March 2015, concerning liquidity risk management in banks and superseding recommendation on liquidity monitoring system of 2002
Recommendation R	Recommendation issued by the Polish Financial Supervision Authority in June 2011 on the principles of identifying impaired balance sheet credit exposures and recognizing impairment losses for balance sheet credit exposures and provisioning for off-balance sheet credit exposures
Recommendation S	Recommendation amended by the Polish Financial Supervision Authority in June 2013 and concerning good practices in managing mortgaged credit exposures
Recommendation T	Recommendation amended by the Polish Financial Supervision Authority in February 2013 and concerning good practices in managing mortgaged credit exposures in the retail segment
Recommendation U	Recommendation issued by the Polish Financial Supervision Authority in June 2014 concerning good practices in the bancassurance market.
VaR	Value at Risk, risk measure determining the threshold loss value determined for a given probability of default
WIBOR	Warsaw Interbank Offered Rate – daily interbank reference rate based on the rate of interest applied by banks to grant unsecured exposures on the wholesale money market in Warsaw

16. Management Board's representation

16.1. True and fair nature of the presented reports

The Management Board of Bank Pocztowy represents that according to its best knowledge:

- the annual consolidated financial statements and the comparative data have been prepared in line with binding accounting principles and provide a true, fair and clear view of the economic and financial position as well as the financial performance of the Bank Pocztowy Capital Group,
- Management Board's report on the activities of the Bank Pocztowy Capital Group provides a true view of the current standing and achievements of the Group, including description of key risks and threats.

16.2. Appointing entity authorized to audit financial statements

The Management Board of Bank Pocztowy S.A. represents that the entity authorized to audit financial statements, Deloitte Polska Sp. z o.o. Sp. k. auditing the annual consolidated financial statements of the Bank Pocztowy Capital Group for 2016, has been appointed in accordance with the law. The entity and certified auditors have fulfilled conditions necessary to issue an unbiased and independent audit opinion on the consolidated financial statements of the Bank Pocztowy S.A. Capital Group in accordance with the valid regulations and professional standards.

The Management Board's report on the activities of the Bank Pocztowy S.A. Capital Group for 2016 includes 127 pages bearing sequential numbers.

Signatures of Management Board Members of Bank Pocztowy S.A.

23 March 2017	Sławomir Zawadzki	Chairman of the Management Board	
23 March 2017	Jerzy Konopka	Member of the Management Board	J Konopka
23 March 2017	Robert Kuraszkiewicz	Member of the Management Board	
23 March 2017	Magdalena Nawara	Member of the Management Board	Magdalena Nawara
23 March 2017	Krzysztof Telega	Member of the Management Board	